Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

LAWRENCE EPSTEIN, *et al.*,

Petitioners,

v.

MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD. and MATSUSHITA HOLDING CORPORATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

APPENDIX

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APPENDIX A — ORDER AND OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT DATED AND FILED JUNE 7, 1999

FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

LAWRENCE EPSTEIN; JOHN LINDER; JANE ROCKFORD, as trustee of the Michael J. Rockford Trust; MAURICE KARLIN; RUTH KARLIN; BETH ANN KARLIN; BERT P. KARLIN,

Plaintiffs-Appellants,

v.

MCA, INC.; MATSUSHITA ACQUISITION CORPORATION; MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD.; MATSUSHITA HOLDING CORPORATION; LEW WASSERMAN; SIDNEY J. SHEINBERG,

Defendants-Appellees.

No. 92-55675

D.C. No. CV-90-6451-R

ORDER AND OPINION

On Remand from the United States Supreme Court
Argued and Submitted
September 4, 1996—San Francisco, California
Opinion Filed October 22, 1997
Petition for Rehearing Granted June 8, 1998
Reargued and Resubmitted
August 21, 1998—San Francisco, California

Opinion Withdrawn June 7, 1999
Filed June 7, 1999

Before: Charles E. Wiggins, Diarmuid F. O'Scannlain, and Sidney R. Thomas, Circuit Judges.

Appendix A

Opinion by Judge O'Scannlain;
Concurrence by Judge Wiggins;
Dissent by Judge Thomas

SUMMARY

Securities/Class Actions

The court of appeals affirmed a judgment of the district court. On remand from the United States Supreme Court, the court held that in a class action by shareholders of a takeover target corporation alleging inequality of treatment among tendering shareholders, a state court judgment that determines the fairness of a settlement is entitled to full faith and credit when the judgment is based on procedures that satisfy due process requirements.

In 1990, appellee Matsushita Acquisition Corporation made a tender offer for appellee MCA, Inc. A class of Delaware shareholders brought claims in state court alleging that MCA's directors breached their fiduciary duties under Delaware law by failing to maximize shareholder value on a change in corporate control. While the Delaware action was pending, appellant Lawrence Epstein and other dissident shareholders filed a federal class action alleging that Matsushita's tender offer violated federal securities laws.

The district court refused to certify the Epstein group as a class, and granted summary judgment against them. While the Epstein group appealed, the Delaware class action settled. The judgment approving the settlement expressly provided for the release of the federal claims that were before the Ninth Circuit.

Noting that the Epstein appellants were members of both the state class and the proposed federal class and did not opt

out of the Delaware settlement, Matsushita contended before the Ninth Circuit that their federal claims were barred by the Delaware judgment under the Full Faith and Credit Act.

In *Epstein I*, the Ninth Circuit held that the Full Faith and Credit Act did not apply because the Delaware settlement released claims exclusively within the jurisdiction of the federal courts under the Securities Exchange Act. The Supreme Court granted certiorari to determine whether the Ninth Circuit could withhold full faith and credit from the Delaware judgment.

The Supreme Court reversed in *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996), holding that the Ninth Circuit could not deny full faith and credit to the Delaware judgment. The Court concluded that the Delaware judgment was entitled to full faith and credit because (1) under Delaware law, the Epstein appellants were bound by the Delaware settlement; and (2) the grant of exclusive federal jurisdiction in § 27 of the Exchange Act did not partially repeal the Full Faith and Credit Act.

On remand, the Ninth Circuit held in *Epstein II* that the Delaware judgment was not entitled to full faith and credit because it violated due process in the inadequacy of the class representation. The panel reversed and remanded the action to the district court. However, a reconstituted panel granted Matsushita's petition for rehearing. On rehearing, the court of appeals withdrew its opinion in *Epstein II*.

[1] The first step of the analysis employed by the Supreme Court to determine whether the Delaware judgment could bar litigation of exclusively federal claims required the Court to look to the law of the rendering state to ascertain the effect of the judgment. **[2]** The Court reviewed Delaware law on the preclusive effect of settlement judgment, and concluded that a Delaware court would have afforded preclusive effect of the settlement judgment in this case. **[3]** Turning to the due pro-

cess requirements for binding absent class members, the Court [4] satisfied itself that they were met.

[5] *Matsushita* necessarily entailed a determination of whether the judgment was constitutionally infirm. If it were, the judgment could not be binding under Delaware law; nor could a federal court afford it full faith and credit. The Supreme Court's holding that under Delaware law the Epstein appellants were bound by the judgment was necessarily premised on the constitutional validity of the Delaware judgment.

[6] The Supreme Court's determination of the preclusive effect of the judgment under Delaware law did not leave open consideration on remand of the adequacy of representation. [7] The absent class members' due-process right to adequate representation is not protected by collateral review, but by the certifying court initially, and thereafter by appeal within the state system, and by direct review in the Supreme Court. [8] Limited collateral review would be appropriate to consider whether the procedures in the prior litigation afforded the party against whom the judgment is asserted a full and fair opportunity to litigate the claim or issue. However, this review would not include reconsideration of the merits.

Judge Wiggins concurred separately to explain why he changed his vote in the case.

Judge Thomas dissented, concluding that the majority inappropriately sanctioned a class settlement obtained without record evidence that the class representatives were even members of the class.

COUNSEL

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Appendix A

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ORDER

The opinion filed on October 22, 1997, and reported at 126 F.3d 1235 (9th Cir. 1997), is withdrawn, and the attached opinion filed in its place.

OPINION

O'SCANNLAIN, Circuit Judge:

We reconsider our decision in this case which is still before us on remand from the United States Supreme Court.

In 1992, the United States District Court for the Central District of California entered summary judgment against plaintiffs-appellants ("the Epstein appellants"). In *Epstein v. MCA, Inc.*, 50 F.3d 644 (9th Cir. 1995) ("*Epstein I*"), we reversed the District Court, and held, among other rulings, that because it released exclusively federal claims, a Delaware state judgment was not entitled to full faith and credit. In *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996) ("*Matsushita*"), the Supreme Court reversed our decision in *Epstein I* and remanded for proceedings consistent with its opinion. On remand we again held, in *Epstein v. MCA, Inc.*, 126 F.3d 1235 (9th Cir. 1997) ("*Epstein II*"), that the Delaware state judgment was not entitled to full faith and credit. We thereafter granted defendants-appellees' ("Matsushita") petition for rehearing, and the case was rear-

gued. We now withdraw our previous opinion, *Epstein II*, and substitute this opinion for it in all respects.

I

In 1990, Matsushita made a tender offer for (and subsequently acquired) MCA, Inc. The tender offer precipitated two lawsuits. On September 26, 1990, a Delaware class brought claims in Delaware's Chancery Court asserting that MCA's directors breached their fiduciary duties to shareholders under Delaware law by failing to maximize shareholder value upon a change in corporate control. On December 3, 1990, while the Delaware class action was pending, the Epstein appellants filed this class action in federal district court asserting that Matsushita's tender offer violated Securities and Exchange Commission Rules 10b-3 and 14d-10 promulgated under the Securities Exchange Act of 1934 ("Exchange Act").

On April 16, 1992, after extensive proceedings, the District Court declined to certify the Epstein appellants as a class and entered summary judgment against them. *See* Second Amended Order, No. 90-6451 (C.D. Cal. filed April 16, 1992). On October 22, 1992, while the appeal of the District Court's decision was pending before us, the Delaware class action was settled. The order and final judgment of the Delaware Chancery Court approving the settlement explicitly provided for the release of the federal claims raised in this action. *See In re MCA, Inc. Shareholders Litig.*, 1993 WL 43024 (Del. Ch. Feb. 16, 1993). Because the Epstein appellants were members of both the state class and the proposed federal class and did not opt out of the Delaware settlement, Matsushita argued before us on appeal that the Epstein appellants' federal claims were barred by the Delaware judgment under the Full Faith and Credit Act, 28 U.S.C. § 1738.

In *Epstein I*, we rejected Matsushita's argument, and held that the Full Faith and Credit Act did not apply because the

Delaware settlement released claims exclusively within the jurisdiction of the federal courts. Addressing the merits, we reversed the district court's entry of summary judgment and denial of class certification.[1] The Supreme Court granted certiorari to decide whether this court could withhold full faith and credit from the Delaware state judgment releasing claims within the exclusive jurisdiction of the federal courts under the Exchange Act.

The Supreme Court held that we could not, concluding that the Delaware judgment was entitled to full faith and credit because (1) under Delaware law, the Epstein appellants were bound by the Delaware class settlement releasing the federal claims, and (2) the grant of exclusive federal jurisdiction in § 27 of the Exchange Act did not partially repeal the Full Faith and Credit Act. The Supreme Court therefore reversed our decision in *Epstein I* and remanded. *See Matsushita*, 516 U.S. at 387.

On remand, a divided panel in *Epstein II* held that despite the Court's holding in *Matsushita*, the Delaware judgment was not entitled to full faith and credit because it violated due process based on the inadequacy of the class representation. The panel therefore reversed and remanded for proceedings consistent with those portions of *Epstein I* that were not reversed by the Supreme Court.

On October 24, 1997, two days after the filing of *Epstein II*, Judge Norris, the author of both *Epstein I* and *Epstein II*, resigned from this court. Matsushita filed a petition for rehearing on November 5, 1997. On January 9, 1998, Judge Thomas was drawn to replace Judge Norris and the reconstituted panel granted the petition for rehearing on June 8, 1998. Following rehearing, we now withdraw our opinion in *Epstein*

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[1]We affirmed the dismissal of an aiding and abetting claim that was conceded by the Epstein appellants.

II and consider anew whether the Epstein appellants are bound by the Delaware judgment.

II

The Epstein appellants assert that, despite the Supreme Court's holding in *Matsushita*, we cannot accord full faith and credit to the Delaware judgment because it violated their due process rights to adequate representation in and judicial supervision of the Delaware proceedings. We are somewhat perplexed by this contention, because *Matsushita*'s holding was explicitly and implicitly premised upon the validity of the Delaware judgment. The Supreme Court stated in *Matsushita* that the Epstein appellant's were "bound . . . by the judgment," 516 U.S. at 379, and held that the exclusively federal claims released by that judgment were not exempted from full faith and credit, *see id.* at 385-87. It should go without saying that we are not free to ignore the Court's determinations in *Matsushita* by holding that the Epstein appellants are *not* bound by the judgment.

A

[1] In *Matsushita*, the Supreme Court commenced its analysis by quoting the Full Faith and Credit Act's mandate "that the 'judicial proceedings' of any State 'shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such State . . . from which they are taken.' " 516 U.S. at 373 (quoting 28 U.S.C. § 1738). Accordingly, the first step of the *Marrese* analysis employed by the Court to determine whether the Delaware judgment could bar the litigation of exclusively federal claims required the Court to "look to the law of the rendering State to ascertain the effect of the judgment." *Matsushita*, 516 U.S. at 375 (citing *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 381-382 (1985)).

[2] Following *Marrese*'s instructions, the Court reviewed Delaware law on the preclusive effect of settlement judg-

ments. The Court's canvas revealed that "[t]he Delaware Supreme Court has [ ] manifested its understanding that when the Court of Chancery approves a global release of claims, its settlement judgment should preclude on-going or future federal court litigation of any released claims." *Id.* at 377. The Court further noted that under Delaware law, a state court settlement of a class action could release or preclude claims only where that settlement was "determined to be fair and to have met all due process requirements." *Id.* at 377-78 (quoting *In re MCA, Inc. Shareholders Litig.*, 598 A.2d 687, 691 (Del. Ch. 1991)). The Court then concluded that "a Delaware court would afford preclusive effect to the settlement judgment in this case." *Id.* at 378.

[3] The Epstein appellants make much of this conditional language, but it merely reflects that the Court had yet to satisfy itself that the proceedings in Delaware had met all the due process requirements for binding absent class members.[2] Turning to these due process requirements, the Court proceeded to march through Delaware Chancery Rule 23, which is, as the Court noted, "modeled on Federal Rule of Civil Procedure 23." *Id.* at 371.

The Court stated that:

> As required by Delaware Court of Chancery Rule 23, *see Prezant v. De Angelis*, 636 A.2d 915, 920 (1994), the Court of Chancery found, and the Delaware Supreme Court affirmed, that the settlement was "fair, reasonable and adequate and in the best interests of the . . . Settlement class" and that notice

[2]We further believe that the Court's conditional language here and elsewhere, *see Matsushita*, 516 U.S. at 380 (stating that "it *appears* that the settlement judgment would be res judicata under Delaware law") (emphasis added), reflects the Court's recognition that the Delaware Supreme Court is the ultimate authority on matters of Delaware law. *See, e.g., Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 413 n.7 (1984).

> to the class was "in full compliance with . . . the requirements of due process." *In re MCA, Inc. Shareholders Litigation*, C.A. No. 11740 (Feb. 22, 1993) . . . . The Court of Chancery "further determined that the plaintiffs[,] . . . as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class." *In re MCA, Inc. Shareholders Litigation*, supra, reprinted in App. to Pet. for Cert. 73a. *Cf. Phillips Petroleum Co.*, supra, at 812, 105 S. Ct., at 2974 (due process requires "that the named plaintiff at all times adequately represent the interests of the absent class members").

Id. at 378-79.

[4] Having satisfied itself that the due process requirements necessary to bind absent class members were met, the Court stated its conclusion:

> Respondents do not deny that, as shareholders of MCA's common stock, they were part of the plaintiff class and that they never opted out; *they are bound, then, by the judgment.*

Id. at 379 (emphasis added). There was nothing conditional about this holding. The Court then proceeded to the second step of the *Marrese* analysis.

B

[5] While the Court's explicit consideration in *Matsushita* of the due process requirements to bind absent class members admittedly did not include an express statement that the Delaware judgment in question did not violate due process, that conclusion was logically necessary to the Court's holding. In *Kremer v. Chemical Construction Corp.*, the Supreme Court made plain that "[a] State may not grant preclusive effect in

its own courts to a constitutionally infirm judgment, and other state and federal courts are not required to accord full faith and credit to such a judgment." 456 U.S. 461, 482 (1982). Thus in *Matsushita*, any resolution of the preclusive effect to be afforded under Delaware law to the Delaware judgment necessarily entailed a determination of whether the judgment was "constitutionally infirm." If the judgment were constitutionally infirm, the judgment could not be binding under Delaware law, nor could a federal court accord it full faith and credit. The Supreme Court's holding in *Matsushita* that under Delaware law the Epstein appellants were "bound, then, by the judgment," *Matsushita*, 516 U.S. at 379, was thus necessarily premised upon the constitutional validity of the Delaware judgment.[3]

It is further worth noting that if, as the Epstein appellants contend, the Delaware judgment violated due process and was invalid, the Court would have had no reason to proceed to step two of the *Marrese* analysis. The Court stated that it would proceed to step two only "[i]f state law indicates that the particular claim or issue would be barred from litigation in a court of that state." *Id.* at 375. Delaware law would bar the federal claims at issue only if the state settlement was

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[3]The Epstein appellants themselves recognize and employ similar logic in their papers. Matsushita cited *Snider v. City Of Excelsior Springs, Missouri*, 154 F.3d 809 (8th Cir. 1998), as supplemental authority demonstrating that the broad collateral review sought by the Epstein appellants is also precluded by the *Rooker-Feldman* doctrine. In response, the Epstein appellants asserted that the Court's decision in *Matsushita* necessarily subsumed a determination that the *Rooker-Feldman* doctrine was inapplicable and federal jurisdiction existed, because *Rooker-Feldman* limits the subject matter jurisdiction of the lower federal courts and thus must be addressed prior to any discussion of preclusion law. (*See* Plaintiffs-Appellants' Rule 28(j) Submission of Sept. 15, 1998, at 1-2.) In light of this argument, the Epstein appellants should similarly recognize that the Court's determination that they were bound by the Delaware judgment necessarily subsumed a determination that the Delaware judgment was constitutionally valid, because states cannot give preclusive effect to constitutionally infirm judgments.

"determined to be fair and to have met all due process requirements." *In re MCA, Inc. Shareholders Litig.*, 598 A.2d 687, 691 (1991). Thus, if the Delaware judgment had not met all due process requirements, the question decided by *Matsushita* would not have been reached, or even presented.[4]

In fact, if the Epstein appellants' contention that the Delaware judgment is constitutionally infirm were true, *Matsushita* would be an advisory opinion. The Court's holding would have answered the purely hypothetical question of the full faith and credit to be accorded a *valid* state judgment releasing exclusively federal claims within the Exchange Act, regardless of the fact that no such valid judgment was before the Court. We will not presume that the Court violated Article III by rendering an advisory opinion. *See, e.g., Mills v. Rogers*, 457 U.S. 291, 305 (1982) (declining to consider merely hypothetical issues in light of the prohibition against advisory opinions); *Flast v. Cohen*, 392 U.S. 83, 96 (1968) (noting the Article III prohibition against advisory opinions).

C

The Epstein appellants assert, however, that the opinion explicitly left the validity of the judgment open, pointing to statements by Justice Ginsburg in her dissent, and by the Court in footnote five. *See Matsushita*, 516 U.S. at 379 n.5. We are not persuaded.

[6] The Epstein appellants rely heavily on Justice Ginsburg's statement that because "the Ninth Circuit decided the case without reaching the due process check on the full faith

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[4]Again, this logic should be familiar to the Epstein appellants. Just as the Epstein appellants asserted that consideration of a court's jurisdiction under *Rooker-Feldman* is logically prior to consideration of preclusion law, (*see* Plaintiffs-Appellants' Rule 28(j) Submission of Sept. 15, 1998, at 1-2), consideration of the validity of a state judgment under step one of the *Marrese* analysis is logically prior to consideration under step two of whether an exception to full faith and credit exists.

and credit obligation, that inquiry remains open for consideration on remand." *Id.* at 389. This belief, however, was not shared by the majority.[5] As Justice Stevens stated in his dissent, he could "join neither [the Court's determination of Delaware preclusion law] nor the Court's judgment" because he agreed with Justice Ginsburg "that the Ninth Circuit remains free to consider whether Delaware courts fully and fairly litigated the adequacy of class representation." *Id.* at 387. This statement demonstrates that the Court's determination of the preclusive effect of the judgment under Delaware law did not leave consideration of the adequacy of representation open on remand.

Justice Ginsburg similarly stated that she concurred only "to the extent that [the Court's judgment] remands the case to the Ninth Circuit," because she objected to the Court's consideration of the content of Delaware preclusion law. *Matsushita*, 516 U.S. at 388. Thus her statement that the due process issue "remains open for consideration on remand," *id.* at 389, is properly viewed as part of her dissent, and has no bearing on whether *Matsushita*'s holding was premised on the validity of the Delaware judgment. Moreover, Justice Ginsburg dissented because she evidently believed that the Court should not have endeavored "to speak the first word on the content of Delaware preclusion law." *Id.* at 388. This statement confirms that the Court did determine the content of Delaware preclusion law, which necessarily included a determination of the judgment's constitutional validity. *See Kremer*, 456 U.S. at 482.

The Epstein appellants also rely on the Court's now famous footnote five, in which the Court declined to address the Epstein appellants' contention "that the settlement proceedings did not satisfy due process because the class was inade-

[5]Which had, as noted previously, seemingly just performed this "due process check" in considering the preclusive effect of the judgment under Delaware law.

quately represented." *Id.* at 379 n.5. They ignore, however, the fact that the Court's statements in footnote five were in reference to a due process challenge "[a] part [sic] from any discussion of Delaware law." *Id.* The footnote does not indicate that the Court had not considered *any* due process concerns, nor would any such reading of the footnote be tenable in the face of the Court's explicit contemplation of the due process requirements to bind absent class members under Delaware law. Nor does the footnote in any way indicate that the Delaware courts had not resolved the issue, or that this determination would not be binding upon the Epstein appellants. Instead, the footnote implies that this determination would be binding by stating that the Epstein appellants "make this claim in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class." *Id.*

Moreover, that the Court declined to address a due process "claim . . . outside the scope of the question presented," *id.*, did not necessarily leave the due process issues the Epstein appellants seek to raise open on remand. While the Court may not have wished to analyze independently every due process challenge to the Delaware judgment available under *Kremer*, its statement in footnote five did not preclude the implicit resolution of such a challenge by the Court's opinion, particularly where the issue the Epstein appellants sought to raise was necessarily intertwined with the Court's holding and discussion of other issues.

We further note that where the Court leaves an issue open on remand, it often expressly states that it has done so. *See, e.g., United States v. O'Hagan*, 117 S. Ct. 2199, 2220 (1997) (stating that petitioner's "other arguments . . . remain open for consideration on remand"); *United States v. Lanier*, 117 S. Ct. 1219, 1228 n.7 (1997) ("We also leave consideration of other issues that may remain open to the Court of Appeals on remand."). Such express statements in the Court's opinions are obviously of far greater weight than a statement in dissent

such as Justice Ginsburg's, and are different in kind from the *Matsushita* majority's statement in footnote five merely declining independently to address the Epstein appellants' due process claim.

III

Apart from any statements in *Matsushita* that the Epstein appellants believe explicitly left open their due process objections on remand, the Epstein appellants assert that *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985), and *Kremer* create a largely unfettered right to challenge collaterally the adequacy of representation in class actions.[6]

A

Shutts does not support the broad collateral review that the Epstein appellants seek. In *Shutts*, the Court identified various

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[6]We note that Delaware law provides no basis for the collateral review that the Epstein appellants seek. As the Court stated in *Matsushita*, "a Delaware court would afford preclusive effect to the settlement judgment in this case." 516 U.S. at 378. The Delaware Supreme Court has explained that under Delaware law:

> Class members . . . will, in all cases, have their interests protected by the requirement that their claims cannot be compromised without . . . a judicial determination that the Rule 23 criteria have been satisfied . . . . *Defendants will be protected from a possible collateral attack on the validity of the settlement by a class member claiming the settlement did not meet the requirements of Rule 23.* This protection will help insure that the final release sought by defendants in settlements is indeed final.

Prezant, 636 A.2d at 925-26 (emphasis added).

As noted by the Court in *Matsushita*, the Delaware Chancery Court made the requisite findings, *see* 516 U.S. at 378-79, thus under *Prezant*, Matsushita is protected from a collateral attack on the validity of the settlement. *See also Hynson v. Drummond Coal Co., Inc.*, 1997 WL 741507, 1-2 (Del. Ch. Nov. 24, 1997) (rejecting class members' attempt to collaterally attack a Delaware judgment on due process grounds under *Shutts*).

procedural safeguards that are necessary to bind absent class members, including notice, the opportunity to be heard, the opportunity to opt out, and adequate representation. 472 U.S. at 812. However, nowhere in *Shutts* did the Court state or imply that where the certifying court makes a determination of the adequacy of representation in accord with *Shutts*, this determination is subject to collateral review. *Shutts* in fact implies that such review is unwarranted by emphasizing that the certifying court is charged with protecting the interests of the absent class members. *See id.* at 809.

[7] Simply put, the absent class members' due process right to adequate representation is protected not by collateral review, but by the certifying court initially, and thereafter by appeal within the state system and by direct review in the United States Supreme Court. *See, e.g., Grimes v. Vitalink Comm. Corp.*, 17 F.3d 1553, 1558 (3rd Cir. 1994) (refusing to allow absent class members collaterally to challenge adequacy of representation because the opportunity to challenge that determination by appeal to Delaware Supreme Court, and thereafter to the United States Supreme Court, "granted all the process that was due"); *Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29, 33 (1st Cir. 1991) (holding that so long as procedural safeguards were employed, objections to the determinations of a certifying court had to be remedied on appeal to the state supreme court or the United States Supreme Court, and not by recourse to the "federal courts in the vain pursuit of back-door relief").

As the Court stated in *Hansberry v. Lee*, "there has been a failure of due process only in those cases where it cannot be said that *the procedure adopted*, fairly insures the protection of the interests of absent parties who are to be bound by it." 311 U.S. 32, 42 (1940) (emphasis added). Due process requires that an absent class member's right to adequate representation be protected by the adoption of the appropriate procedures by the certifying court and by the courts that

review its determinations; due process does not require collateral second-guessing of those determinations and that review.

B

Kremer does not indicate otherwise. As we have noted previously, *Kremer* held that neither state nor federal courts are required to give full faith and credit to a constitutionally infirm judgment. *See Kremer*, 456 U.S. at 482. The extent of collateral review is, however, limited.

[8] *Kremer* merely recognized that a judgment is not entitled to full faith and credit "if there is reason to doubt the quality, extensiveness, or fairness of *procedures* followed in prior litigation." *Id.* at 481 (quoting *Montana v. United States*, 440 U.S. 147, 164 n.11 (1979)) (emphasis added). Limited collateral review would be appropriate, therefore, to consider whether the procedures in the prior litigation afforded the party against whom the earlier judgment is asserted a "full and fair opportunity" to litigate the claim or issue. *Id.* at 480. This review would not, however, include reconsideration of the merits of the claim or issue, *see id.* at 483-85 (declining to reexamine the facts underlying or the merits of Kremer's claim, and instead examining the procedures provided), and such a challenge would most likely fail because "state proceedings need do no more than satisfy the minimum procedural requirements of the Fourteenth Amendment's Due Process Clause in order to qualify for the full faith and credit guaranteed by federal law." *Id.* at 481.

C

Matsushita itself indicates that broad collateral review of the adequacy of representation (or of the other due process requirements for binding absent class members) is not available. *Matsushita* made plain that class action judgments are accorded full faith and credit like other judgments:

> That the judgment at issue is the result of a class action, rather than a suit brought by an individual, does not undermine the initial applicability of § 1738. The judgment of a state court in a class action is plainly the product of a "judicial proceeding" within the meaning of § 1738. Therefore, a judgment entered in a class action, like any other judgment entered in a state judicial proceeding, is presumptively entitled to full faith and credit under the express terms of the Act.

Matsushita, 516 U.S. at 373-74 (citations omitted).

The Court did, of course, address the additional due process requirements for binding absent class members, stating, by way of example, that "due process for class action plaintiffs requires 'notice plus an opportunity to be heard and participate in the litigation,' " and " 'that the named plaintiff at all times adequately represent the interests of the absent class members.' " *Id.* at 378-79 (quoting *Shutts*, 472 U.S. at 812). The Court, however, satisfied itself that these requirements had been met *by referencing the Delaware courts' findings on these matters*, rather than by independently determining whether the requirements were met. *See id.*[7]

After this analysis, the Court stated the seemingly uncontroversial proposition that:

> Under Delaware Rule 23, as under Federal Rule of Civil Procedure 23, "[a]ll members of the class, whether of a plaintiff or a defendant class, are bound by the judgment entered in the action unless, in a Rule 23(b)(3) action, they make a timely election for

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[7]We further note that the Court's citation of *Shutts*, immediately after referencing the findings of the Delaware courts' regarding the due process requirements, belies the Epstein appellants' assertion that *Shutts* supports collateral review of these determinations.

> exclusion." 2 H. Newberg, *Class Actions* § 2755, p. 1224 (1977).

Id. at 379. The Court also cited *Cooper v. Federal Reserve Bank of Richmond* for the proposition that "[t]here is of course no dispute that under elementary principles of prior adjudication a judgment in a properly entertained class action is binding on class members in any subsequent litigation." 467 U.S. 867, 874 (1984).

The Court's statements in no way imply that a class member who fails to opt out is not bound until collateral review of the adequacy of representation reveals that due process has been satisfied. Nor is there any indication that a "properly entertained" class action is other than one in which a certifying court employs the appropriate procedures to determine that the due process requirements embodied in Rule 23 have been met. Any such implication would be belied by the Court's analysis of the issue because these statements followed on the heels of the Court's review of the Delaware courts' determinations that the Rule 23 requirements were satisfied.

Even footnote five, so heavily relied upon by the Epstein appellants, makes the same point. There, the Court specifically noted that the Epstein appellants sought to challenge collaterally the adequacy of representation "in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class." *Matsushita*, 516 U.S. at 379 n.5. The Court then cited *Prezant v. De Angelis* for the proposition that the "constitutional requirement [of adequacy of representation] is embodied in [Delaware] Rule 23(a)(4)." *Id.* (alterations in the original). These statements indicated that the Epstein appellants' challenge to the adequacy of representation in the Delaware proceedings was answered by specific reference to the findings made on the issue in those proceedings.

Appendix A

IV

For the foregoing reasons, the Delaware judgment was not constitutionally infirm and must be accorded full faith and credit. The district court's decision of April 16, 1992 is

AFFIRMED.

WIGGINS, Circuit Judge, concurring:

I concur in the result of Judge O'Scannlain's majority opinion. I write separately to explain why I changed my vote in this appeal.

The long history of this case evinces the complexity of the issues involved. In our original disposition, we found that the Delaware judgment was not a bar to further prosecution of the federal action under the Full Faith and Credit Act, 28 U.S.C. § 1738. *See Epstein v. MCA, Inc.*, 50 F.3d 644 (9th Cir. 1995). The Supreme Court reversed, concluding that the Delaware judgment was entitled to full faith and credit even if it released claims within the exclusive jurisdiction of the federal courts. *See Matsushita Elec. Indus. Co., Ltd. v. Epstein*, 516 U.S. 367 (1996)("*Matsushita*"). Following remand, we were presented with the issue that is the subject of this appeal.

After our initial consideration of this appeal, I joined Judge Norris' well-written opinion. *See Epstein v. MCA, Inc.*, 126 F.3d 1235 (9th Cir. 1997). We found that the adequacy of representation issue was left open by the Supreme Court and was not fully and fairly litigated in state court. *See id.* at 1237-48. Proceeding to the merits of the adequacy of representation issue, the opinion convincingly concluded that Delaware counsel provided inadequate representation: "This was not merely 'inadequate' representation, it was hostile representation that served the interests of counsel in getting a fee, but

did not serve the interests of the MCA shareholders in getting a settlement based upon a thorough and fair assessment of their Exchange Act claims." *Id.* at 1255.

I remain troubled by the substance of the Delaware settlement. Soon after the opinion was filed, however, I began to have grave doubts about the conclusion that the adequacy of representation issue was not fully and fairly litigated in the Delaware courts. It is this issue that led me to change my vote.

I now believe that, while the Supreme Court did not conclusively resolve the due process issue before the remand, it did send unmistakable signals on that very issue. In three separate passages, the Court indicated that the Delaware courts likely had already conclusively resolved the due process issue.[1] Our original majority disposition in this appeal did not give sufficient weight to these admonitions.

The Supreme Court's conclusion is clearly supported by the record. One of the objectors, William Krupman, explicitly opposed the proposed settlement because "the purported class representatives . . . had proposed a settlement that benefitted no one but their own attorneys. *They did not provide adequate*

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[1]First, in Part I of it opinion, as it described the procedural posture of the case it stated that "[a]fter argument from several objectors, the [Chancery] court found the class representation adequate . . . ." *Matsushita*, 516 U.S. at 371. Later, in explaining why it believed that the Delaware courts would afford preclusive effect to the settlement judgment, the Supreme Court explained that "[t]he Court of Chancery 'further determined that the plaintiffs[,] . . . as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class." *Id.* at 378 (quoting Order and Final Judgment at 2, *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024 (Del.Ch. Feb. 22, 1993))(internal quotation marks omitted). Finally, the Court expressed its astonishment at plaintiffs' decision to assert their due process claim "in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class." *Id.* at 379 n.5.

representation to the class." Affidavit of William A Krupman at 2-3, *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024 (Del. Ch. Feb. 16, 1993) (emphasis added). In considering Krupman's objection, the Chancery Court felt that his objection concerning the adequacy of the class representatives' representation of the class members was similar to the objection raised by another objector, Pamela Minton de Ruiz, who objected to the settlement "on the basis that the settlement is collusive." *In re MCA, Inc. Shareholders Litig.* 1993 WL 43024 *3. The Chancery Court nonetheless approved the settlement because the settlement was "in the best interest of the class," notwithstanding these objections to the adequacy of the class representatives' representation. *Id.*

Because the adequacy of representation issue was fully and fairly litigated and necessarily decided in the Chancery Court, the Delaware courts would give preclusive effect to that determination. *See Messick v. Star Enter.*, 655 A.2d 1209, 1211 (Del. 1995). The Full Faith and Credit Act, 28 U.S.C. § 1738, requires that we "treat a state court judgment with the same respect that it would receive in the courts of the rendering state." *Matsushita*, 516 U.S. at 373. As such, we are required to give preclusive effect to the Chancery Court's judgment that class representation was adequate irrespective of whether we agree with that determination. I therefore concur.

THOMAS, Circuit Judge, dissenting:

Amchem Prods., Inc. v. Windsor, 521 U.S. 591 (1997) heralded a new era of judicial scrutiny of class action certification and settlement. The majority opinion marks a significant retreat from that philosophy, sanctioning a class settlement obtained without any record evidence that the class representatives were even members of the class. Because the Delaware judgment extinguished the rights of absent class members

without affording them due process of law, I respectfully dissent.[1]

I

Before hedging its bet by reaching the merits, the majority first concludes that we are precluded from deciding the due process questions presented to us because the Supreme Court has already done so. The opening passage of *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996) belies this:

> This case presents a question whether a federal court may withhold full faith and credit from a state-court judgment approving a class-action settlement simply because the settlement releases claims within the exclusive jurisdiction of the federal courts.

Id. at 369.

The Court further explained:

> We need not address the due process claim [of inadequate representation] . . . because it is outside the scope of the question presented in this Court. *See Yee v. Escondido*, 503 U.S. 519, 533 (1992). While it is true that a respondent may defend a judgment on alternative grounds, we generally do not address arguments that were not the basis for the decision below. *See Peralta v. Heights Medical Center*, Inc. 485 U.S. 80, 86 (1988).

Id. at 379, n.5 (1996).

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[1]Insofar as is possible, I shall not repeat Judge Norris's forceful analysis, as detailed in the panel opinion on remand. *See Epstein v. MCA, Inc.*, 126 F.3d 1235 (9th Cir. 1997). It demands an independent and careful examination and is, in my view, dispositive.

If the majority's recognition of the scope of its holding were not already plain, Justice Ginsburg's partial concurrence makes it pellucid:

> Although the Ninth Circuit decided the case without reaching the due process check on the full faith and credit obligation, that inquiry remains open for consideration on remand.

Id. at 389.

The nuances that the majority strains to draw from the opinion simply cannot bear the weight placed on them. There is nothing in the opinion that relieves us of our responsibility to examine the merits of the due process argument fully and fairly. Indeed, if any unmistakable signal were sent by the opinion, it was to do just that.

II

Judgments binding absent litigants in class action suits are an exception to the general rule that one is not bound by a judgment in personam in a litigation to which he or she is not a party. *See Hansberry v. Lee*, 311 U.S. 32, 40-41 (1940). Absent class members may be bound by the judgment if they have, in fact, been adequately represented by parties who are present. *Id.* at 42-43. Due process requires that the procedure employed to reach a binding judgment "fairly insures the protection of the interests of absent parties who are to be bound by it." *Id.* at 42.

This is, in the words of the *Hansberry* court almost sixty years ago, a "familiar doctrine." *Id.* Yet its import seems lost in this case. In order for absent class members to have "adequate representation" within the meaning of the Due Process Clause, the class must be free of structural conflict. Although analyzed in the context of Fed. R. Civ. P. 23, this proposition was central to the seminal analysis in *Amchem*.

521 U.S. at 625-628. In a class settlement, there must be "structural assurance of fair and adequate representation for the diverse groups and individuals affected." *Id.* at 627. The class representative "must possess the same interest and suffer the same injury shared by all members of the class he represents." *Schlesinger v. Reservists to Stop the War*, 418 U.S. 208, 216 (1974).

In the case at hand, there were three different types of shareholders who were part of the class: (a) those who traded on the open market; (b) those who tendered their shares; and (c) those who received spin-off shares. In addition, there were differences among the class members as to the legal theories available. The interests of the Epstein plaintiffs in advancing the federal claims were directly antagonistic to those of the Delaware class representatives, who were precluded by federal securities law from asserting those claims in state court. By the time settlement occurred, the statute of limitations prevented the Delaware class from litigating the federal claims in any court. Thus, there were irreconcilable differences in claims and damages among the class members. These structural conflicts should have actuated an inquiry by the Delaware Vice-Chancellor, and should have resulted in the creation of sub-classes to assure the adequate representation of absent class members.

The conflict prior to settlement approval was palpable. Because they could not assert federal causes of action, those claims were of no value to the class representatives and their counsel except as a bargaining chip to enhance the value of their state claims. Indeed, settlement of the federal action was the only method by which the Delaware class could receive any money from the federal claims. Thus, it was plainly in the best interest of class representatives to settle the federal claims at any price. Class representatives had absolutely no incentive to obtain fair valuation of the federal claims, because of their inability to assert the claims.

The divergence of class interests quickly manifested itself. While Delaware counsel was admitting to the Chancery Court that they had reviewed the Wasserman claim "relatively quickly" and in the complete absence of discovery, before concluding that the claim was "frivolous," the MCA shareholders were extensively litigating that very claim in federal district court in this Circuit. And while the Delaware counsel was arguing before the Chancery Court that the Ninth Circuit was "unlikely" to overturn the district court's dismissal of the Wasserman claim, the MCA shareholders were in the process of successfully appealing that decision before this court. In addition to the inadequate representation of the Wasserman issue, it is also noteworthy that there is not a single mention of the $21 million payment to Sheinberg in the Delaware counsel's memoranda or arguments to the Chancery Court, although it is clear that Delaware counsel was aware of this claim, which had a potential value of $17.80 per share.

"[A]dequate representation . . . depends on . . . an absence of antagonism." *Brown v. Ticor Title Insurance Co.*, 982 F.2d 386, 390 (9th Cir. 1992). In this case, the antagonistic interests, injury and claims among the class members resulted in significant structural conflicts. Because these conflicts were unresolved, the class representation was constitutionally infirm and cannot bind absent class members.

In addition, the actual representation provided by Delaware class counsel was inadequate for reasons persuasively detailed in Judge Norris's opinion on remand. *See Epstein*, 126 F.3d at 1251-55. Class counsel did not investigate or properly evaluate the federal claims. Class counsel provided a misleading and incorrect analysis of the claims to the Chancery Court. The interests of the Epstein plaintiffs were not represented adequately by class counsel; indeed, their interests were undermined by the antagonistic strategy of class counsel.

Finally, there is no record evidence that the class representatives were even members of the putative class. A non-

waivable prerequisite to approval of a class settlement binding absent class members is that the class representative be a member of the class. *See East Motor Freight System, Inc. v. Rodriquez*, 431 U.S. 395, 403 (1977) ("As this Court has repeatedly held, a class representative must be part of the class . . . ."). The best argument that the class representatives could offer was that such an allegation was contained in the complaint, that there were a large number of law firms involved and that the settlement was accepted by class members.[2] None of this, of course, comes close to being record evidence. This explanation can be credited only if one believes that representational adequacy or adherence to procedural due process may be established by circumstantial evidence.

The majority decision correctly observes that *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985), enumerated "various procedural safeguards that are necessary to bind

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[2]The class representatives did not reply to this charge in their briefs. At oral argument, the following colloquy occurred:

> "Question: Where is there evidence in the record that any of the named representatives were actually members of the class?
>
> Answer: In the Delaware proceeding, there were twelve different class representatives, represented by twenty different law firms and all of them were possessed of the state and federal claims that were resolved in the Delaware action.
>
> Question: Is your answer basically that there is nothing of evidence in the record, but everyone was on notice and you are relying on that?
>
> Answer: I'm certainly relying on the fact that a notice went to every single class member outlining the settlement, the pendency of the federal action, the pendency of state action, what each class member would receive and what each member would forfeit, and I'm relying on the fact that the settlement proceeds which were accepted by all class members, including the Epstein plaintiffs, were only paid to shareholders who tendered pursuant to the tender offer and I'm relying on the fact that the Delaware complaint was brought on behalf of all MCA shareholders."

absent class members." In fact, *Shutts* specifically indicates that "the Due Process Clause of course requires that the named plaintiff at all times adequately represents the interests of the absent class members." 472 U.S. at 812 (*citing Hansberry v. Lee*, 311 U.S. 32, 42-43 (1940)). The litigation leading up to the Delaware settlement thus violated the "minimal procedural due process protection" due to the Epstein plaintiffs: adequate representation "at all times."

"[I]f the plaintiff was not adequately represented in the prior action, or there was a denial of due process, then the prior decision has no preclusive effect." *Brown*, 982 F.2d at 386. Thus, the Epstein plaintiffs are entitled as a matter of federal law to assert their claims in this action.

III

In addition to federal due process concerns, the Delaware Supreme Court's own interpretation of Delaware Chancery Courts Rule 23, as articulated in *Prezant v. De Angelis*, 636 A.2d 915 (Del. 1994), requires us to address the Epstein plaintiffs' collateral attack of this settlement on the grounds of inadequate representation. Under Delaware law, issue preclusion attaches only when a question of fact essential to the judgment actually has been litigated and determined by a valid and final judgment. *Messick v. Star Enterprise*, 655 A.2d 1209, 1211 (Del. 1995); *Orange Bowl Corp. v. Jones*, 1986 WL 13095, at *2 (Del. Super. 1986); *Evans v. Frank E. Basil, Inc.*, 1986 WL 3973, at *2 (Del. Super. 1986). The Delaware record shows that the issue of adequacy of representation was not litigated during the settlement proceedings.

The notice to the class members regarding the settlement hearing did not indicate that the issue of adequacy of representation, either by class representative or by class counsel, would be addressed.

Perhaps as a consequence of the absence of notice, the four objectors who participated in the Delaware proceedings did

not litigate the question of the adequacy of representation. In addressing the concerns that were litigated by the objectors, the Delaware Chancery Court first determined that the fact that few small shareholders would actually opt out of the settlement, as was their right, did not undermine the validity of the settlement agreement. *In re MCA, Inc. Shareholders' Litigation*, 1993 WL 43024, at *4. Second, it determined that it did not need to await the Ninth Circuit's appellate decision in the *Epstein* matter in order to approve the settlement. *Id.* at *5. Third, the Chancery Court concluded that those shareholders who received delayed notice had assumed the risk of such delays in holding their shares under a "street name." *Id.* And finally, it determined that there was insufficient evidence to support the objectors' claim that the agreement was a collusive means of obtaining settlement of the federal claims. *Id.*

Of these four explicit findings, it is clear that only the second and fourth claim are even tangentially relevant to the claims raised by the Epstein plaintiffs before this court today. The second finding indicated that the valuation of the state claims were not dependant upon the resolution of the federal matter. But the Chancery Court did not assert that the plaintiffs raising the federal claims were adequately represented in the Delaware action. The fourth finding simply makes clear the fact that there was no collusive settlement "deal" between the plaintiffs and attorneys on both sides of the state court matter. The fact that there was no finding of wrongdoing certainly does not preclude a finding that the federal plaintiffs were inadequately represented by the settling class.

In short, none of the Chancery Court's findings address the claim of the plaintiffs before this court today: namely, that the federal plaintiffs were inadequately represented before the Delaware court, and that, consequently, a decision to bind them to the terms of the settlement would violate their rights to due process.

The Epstein plaintiffs correctly argue that to be bound by the settlement decision they are entitled under Delaware law

to specific findings that they were adequately represented in the Delaware Chancery Court. Such findings are required in order to bind the federal litigants to the settlement terms. In *Prezant*, 636 A.2d at 924, the Delaware Supreme Court explicitly held that a Court of Chancery is required to "articulate on the record its findings regarding the satisfaction of the Rule 23 criteria and supporting reasoning." Yet the statement offered by the Delaware Chancery Court asserting that the plaintiffs in the action "fairly and adequately protected the interests of the Settlement Class" offers no "supporting reasoning" aside from that offered to address the challenges raised by the four objectors. No findings exist in the Chancery Court's decision that would indicate that the representation of the absent federal plaintiffs was adequate, because the matter was never actually litigated before that court.

Thus, while the Supreme Court decision in *Matsushita* makes it clear that the objectors will be bound by the judgment of the Delaware court with respect to the matters litigated,[3] the Delaware court's decision cannot be read to bind those whose claims were simply never represented before it. The individual objectors who voluntarily appeared at the fairness hearing were not authorized by the absent class members to represent their interests, nor were they certified by the state to do so. Their appearance at the hearing could therefore not bind other parties with respect to the issue of adequacy of representation.[4] Thus, the majority's determination today also runs against the settled law of Delaware.

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[3]Thus, interpreting the *Matsushita* decision to leave the Epstein plaintiffs' due process claim open for determination on remand does not, as the majority contends, render *Matsushita* an "advisory decision." On the contrary, the Court's decision makes it clear that all participants in the Delaware action will be bound by the judgment in spite of the exclusively federal nature of any claims they sought to raise elsewhere.

[4]This conclusion does not undermine the finality of a class action settlement to any degree greater than that already permissible under the law. In *Prezant*, the Delaware Supreme Court pointed out that prudent class action defendants can foreclose subsequent collateral action absolutely by asking for a judicial finding, supported through reasoning and evidence, that all plaintiffs' "due process right to adequate representation has been satisfied." 636 A.2d at 925-26. Such a finding simply was not made in this case.

Appendix A

IV

Providing the Epstein plaintiffs with the opportunity to raise their due process claims does not, as the majority claims, result in the "collateral second guessing" of the determinations and review of the Delaware courts. Those determinations are valid, and, to the extent that they comply with due process protections afforded by the Constitution, they are binding upon this court. Thus, the result originally reached by the panel on remand was not violative of cooperative federalism or comity. The majority today gives license to those who would run to a favorable and remote state court to obtain settlements premised on bargain-basement valuations of federal claims, even when those claims clearly predominate over potential state causes of action. This result must be especially discouraging to responsible law firms specializing in class action suits, who assiduously and carefully construct subclasses to assure adequate representation of diverse interests, even at the expense of their own fees.

The Epstein plaintiffs seek to raise claims that received neither determination nor review in the Delaware courts. Structural conflicts of interest precluded adequate representation of absent class members. The Epstein plaintiffs were not adequately represented in the Delaware state court proceedings by either the class representatives or the objectors, and their claim was never litigated in Delaware state court. In denying them the right to bring their meritorious federal claims before us, we deny them due process of law. We also significantly diminish the proper oversight role of the judiciary over class action settlements.

I respectfully dissent.

APPENDIX B — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT DATED AND FILED OCTOBER 22, 1997

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 92-55675

D.C. No. CV-90-6451-R

LAWRENCE EPSTEIN; JOHN LINDER; JANE ROCKFORD, as trustee of the Michael J. Rockford Trust; MAURICE KARLIN; RUTH KARLIN; BETH ANN KARLIN; BERT P. KARLIN,

Plaintiffs – Appellants,

v.

MCA, INC.; MATSUSHITA ACQUISITION CORPORATION; MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD; MATSUSHITA HOLDING CORPORATION; LEW WASSERMAN; SIDNEY J. SHEINBERG,

Defendants – Appellees.

OPINION

On Remand from the United States Supreme Court
Argued and Submitted September 4, 1996
San Francisco, California
Filed October 22, 1997

Appendix B

Before: NORRIS, WIGGINS, and O'SCANNLAIN, Circuit Judges.

NORRIS, Circuit Judge:

This case is before us on remand from the United States Supreme Court. In *Matsushita Electric Industrial Co. v. Epstein*, 116 S. Ct. 873 (1996) ("*Matsushita*"), the Court reversed our judgment in *Epstein v. MCA, Inc.*, 50 F.3d 644 (9th Cir. 1995) ("*Epstein I*"), and remanded "for proceedings consistent with this opinion." *Matsushita*, 116 S. Ct. at 884.

The case is a class action brought by former MCA shareholders who surrendered their stock in response to a tender offer by Matsushita. In *Epstein I*, the named plaintiffs ("the Epstein plaintiffs") contended, *inter alia*, that Matsushita's tender offer violated the so-called "all-holder, best-price" rule of SEC Rule 14d-10[1] by paying a premium for the stock of MCA's chairman and chief executive officer, Lew Wasserman, and MCA's chief operating officer, Sidney Sheinberg.[2] The district court awarded summary judgment to the defendants, and the Epstein plaintiffs appealed.

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1. Rule 14d-10, 17 C.F.R. § 240.14d-10 (1994), is promulgated under Section 14(d)(7) of the 1968 Williams Act Amendments [hereinafter "The Williams Act"] to the Securities Exchange Act of 1934, 15 U.S.C. § 78n(d)(6)-(7) (1994) [hereinafter "The Exchange Act"].

2. The Epstein plaintiffs also claimed that the premiums paid to Messrs. Wasserman and Sheinberg violated SEC Rule 10b-13, 17 C.F.R. § 240.10b-13 (1994). We did not consider the Rule 10b-13 claim in *Epstein I* because any relief that the Epstein plaintiffs could have obtained under Rule 10b-13 was also available under Rule 14d-10. *See Epstein I*, 50 F.3d at 648 n.5.

Appendix B

In *Epstein I* we reversed the summary judgment for Matsushita, holding that its agreement to purchase Mr. Wasserman's stock for consideration different from what it offered other shareholders violated Rule 14d-10, *see Epstein I*, 50 F.3d at 653-57, and that there was a material issue of fact as to whether a $21-million dollar payment to Mr. Sheinberg was legitimately made as incentive compensation for past services or was a premium for his stock paid in violation of Rule 14d-10. *See id.* at 657-59. We rejected Matushita's argument that there was no private right of action under § 14(d)(7) of the Williams Act, following the decisions of the Second and Third Circuits on that point.[3] *See id.* at 649-52. We also rejected Matsushita's argument that its purchase of Mr. Wasserman's stock could not have violated Rule 14d-10 because his stock was not exchanged until one hour after Matsushita accepted the tendered MCA shares for payment. *See id.* at 654-57. We also held that the district court had abused its discretion in refusing to certify the class because "[t]he claims of every tendering shareholder turn on identical facts and law — regardless of the identity or circumstances of the particular shareholder." *Id.* at 668. Finally, we affirmed the district court's dismissal of the "aiding and abetting" claims against MCA and Messrs. Wasserman and Sheinberg personally in light of the Epstein plaintiffs' concession on the issue. *See id.* at 665 n.29.

None of these rulings on the merits of the Rule 14d-10 claims were disturbed by the Supreme Court in *Matsushita*. The Court reversed our judgment and remanded for further

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3. *See Polaroid Corp. v. Disney*, 862 F.2d 987, 996 (3d Cir. 1988); *Field v. Trump*, 850 F.2d 938, 946 (2d Cir. 1988).

proceedings solely on the basis of the first question presented in Matsushita's petition for the writ of certiorari: "Whether a federal court can withhold full faith and credit from a state court final judgment approving a class action settlement simply because the settlement released exclusively federal claims."[4] *Matsushita Electric Indus. Co. v. Epstein*, 115 S. Ct. 2576 (1995) (granting certiorari limited to Question 1 presented by the petition for writ of certiorari); *see also Matsushita*, 116 S. Ct. at 884 (remand order).

On remand, the Epstein plaintiffs press anew an argument that we found unnecessary to address in *Epstein I*: that we should withhold full faith and credit from the Delaware judgment because it was entered into in violation of the due process right of the absent class members to adequate representation at all times. We now turn to that question.

I

Matsushita contends that we are barred from addressing the merits of the Epstein plaintiffs' claims of inadequate representation. Matsushita makes three arguments in support of this contention:

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4. The Supreme Court accepted Matsushita's statement of the question presented even though that statement mischaracterized our holding. We did not withhold full faith and credit "simply" because the Delaware judgment released exclusively federal claims. Rather, we withheld full faith and credit because the great disparity between the state and federal claims — there were no overlapping issues of fact whatsoever (*see Epstein I* at 665-66) — meant that a judgment based upon an adjudication of the state claims could have no issue preclusive effect on the federal claims.

Appendix B

(1) The Supreme Court's decision in *Matsushita* did not leave the issue open on remand;

(2) The issue of the adequacy of representation was fully and fairly litigated in the Delaware Court of Chancery;

(3) The Epstein plaintiffs are estopped from raising the adequacy of their representation collaterally because they did not raise it by intervening in the Delaware proceeding.

A

In arguing that the "[t]he opinion of the Supreme Court leaves no issue open on remand," Appellees' Br. at 1, Matsushita either mischaracterizes or disregards the unambiguous statements in the record to the contrary:

1. Matsushita fails to cite the Court's order granting certiorari, which limited the question it would review to Question 1 in Matsushita's petition. *See Matsushita Electric Industrial Co. v. Epstein*, 115 S. Ct. 2576 (1995); *see also Matsushita*, Pet. for Cert., at i ("1. Whether a federal court can withhold full faith and credit from a state court final judgment approving a class action settlement simply because the settlement includes a release of exclusively federal claims.").

2. Matsushita fails to include the first sentence of the Court's opinion which limited the question presented precisely the way Matsushita stated it in its petition for certiorari:

> This case presents the question whether a federal court may withhold full faith and credit from a state-court judgment approving a class-action settlement simply because the settlement releases claims within the exclusive jurisdiction of the federal courts.

Matsushita, 116 S. Ct. at 875-76.

3. Matsushita, although quoting various excerpts from the Court's opinion, fails to quote the following explicit statement by the Court that it did not address the due process claim:

> We need not address the due process claim [of inadequate representation] . . . because it is outside the scope of the question presented in this Court. *See Yee v. Escondido*, 503 U.S. 519, 533, 112 S. Ct. 1522, 1531, 118 L.Ed.2d 153 (1992). While it is true that a respondent may defend a judgment on alternative grounds, we generally do not address arguments that were not the basis for the decision below. *See Peralta v. Heights Medical Center, Inc.*, 485 U.S. 80, 86, 108 S. Ct. 896, 899, 99 L.Ed.2d 75 (1988).

Id. at 880, n.5.

4. Matsushita also fails to cite the explicit statement in Justice Ginsburg's separate opinion that the due process question of adequate representation remained open on remand, a statement that went unchallenged by any member of the Court:

> Mindful that this is a court of final review and not first view, I do not address the merits of the Epstein plaintiffs' contentions [regarding the adequacy of representation], or Matsushita's counterargument that the issue of adequate representation was resolved by full and fair litigation in the Delaware Court of Chancery. *These arguments remain open for airing on remand.*

Id. at 890 (Ginsburg, J., concurring in part and dissenting in part) (emphasis added).

5. Finally, in arguing that the due process question is not open on remand, Matsushita ignores its *own* assertions to the Court that the question was not before it for decision. In their brief, the Epstein plaintiffs invited the Court to address the adequacy of representation issue, notwithstanding that it was outside the scope of the sole question on which the Court had granted certiorari. *See Matsushita* Resp. Br. at 34-45. In its Reply Brief, Matsushita responded:

> A. The Ninth Circuit Opinion is Not Predicated Upon Any Due Process Issue.
>
> Respondents invite this Court to find constitutional infirmity in the Delaware proceedings based on alleged inadequate representation and judicial supervision. Resp. Br. at 34-45. As respondents concede, the Ninth Circuit's holding is *not* predicated on these fact-

> specific issues. Resp. Br. at 8. Accordingly, this Court should decline to address them.

Matsushita Reply Br. at 13.

Given this state of the record, we must agree with the Epstein plaintiffs that Matsushita's argument that the due process question is not open on remand is "inexplicable." Reply Br. at 4. Matsushita attaches no weight to the Supreme Court's clear disclaimer that "We need not address the due process claim," *Matsushita*, 116 S. Ct. at 880, n.5., and all the other references in the record that reaffirm this disclaimer.

Instead, Matsushita attempts to get around the Court's unambiguous disclaimer. First, it seizes upon language in the Court's opinion concerning Delaware preclusion law and lifts it out of context. "State-court approval of the settlement would have the collateral effect of preventing class members from prosecuting their claims in federal court." *Matsushita*, 116 S. Ct. at 879; *accord* Appellees' Br. at 12. While an accurate summary of the Supreme Court's reading of Delaware preclusion law, this passage lends no support to the argument that the Supreme Court addressed, let alone disposed of, the Epstein plaintiffs' inadequate representation claim.

Matsushita's position that the Court in *Matsushita* *implicitly* held that the Delaware proceeding satisfied due process reads volumes between the lines. When taken in the face of the Court's explicit announcement that it did *not* render such a holding, we agree with the Epstein plaintiffs that it becomes nothing less than "incomprehensible." Appellants' Br. at 5.

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Matsushita's second ground for arguing that adequacy of representation is not open on remand rests on the very footnote — from which it selectively excerpts — in which the Court expressly stated that it was *not* addressing due process. Matsushita misleading quotes only the first part of the footnote, which reads as follows:

> A part [sic] from any discussion of Delaware law, respondents contend that the settlement proceeding did not satisfy due process because the class was inadequately represented. . . . Respondents make this claim in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class. . . .

Id. at 880, n.5 (citations omitted). Matsushita omits the very next sentence of the footnote, however, in which the Court made clear that it was not disposing of the due process claim.

> We need not address the due process claim, however, because it is outside the scope of the question presented in this Court.

Id.

Matsushita would have us believe that the Court was "winking" at us — saying that it was not doing exactly what it was doing. The only reasonable interpretation of these sentences, however, is that the Court was simply stating the claim of the Epstein plaintiffs that their representation in the Delaware proceeding was constitutionally inadequate.

In sum, we reject Matsushita's argument that the Supreme Court did not leave the due process issue open on remand. The Court laid out an unambiguous contrary intention in its statement of the question presented and in footnote five, and no voice was raised against Justice Ginsburg's explicit statement that the issue of adequacy of representation "remain[ed] open for airing on remand." *Id.* at 890 (Ginsburg, J., concurring in part and dissenting in part).

B

Next we address Matsushita's argument that the Delaware settlement judgment precludes the Epstein plaintiffs from "relitigating" the issue of adequacy of representation under Delaware issue preclusion law. It claims that adequacy of representation was actually litigated by objectors at the Delaware fairness hearing, and that other Delaware courts would therefore give preclusive effect to the Chancery Court's determination that representation of the absent class members was adequate. Appellees' Br. at 16-18, 21-24, 22 n.6. Therefore, Matsushita argues, under 28 U.S.C. § 1738, we too must attach issue preclusion. *See id.* at 23.

The Epstein plaintiffs argue in response that the Delaware judgment raises no issue preclusion bar to the question of constitutional adequacy of representation. First, they contend, the objectors did not actually litigate the issue at the Delaware fairness hearing, as is required under Delaware issue preclusion law. *See* Appellants' Br. at 21-23; Reply Br. at 10. More broadly, the Epstein plaintiffs

contend that individual, uncertified objectors in a class action cannot constitutionally bind absent class members on the issue of adequacy of representation. *See id.* at 17-18. We consider each contention in turn.

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Under Delaware law, issue preclusion attaches only when a question of fact essential to the judgment has been actually litigated and determined by a valid and final judgment. *See Messick v. Star Enterprise*, 655 A.2d 1209, 1211 (Del. 1995) ("The test for applying collateral estoppel requires that (1) a question of fact essential to the judgment, (2) be litigated and (3) determined (4) by a valid and final judgment.") (internal quotations omitted) (emphasis added); *Orange Bowl Corp. v. Jones*, 1986 WL 13095, at * 2 (Del. Super. 1986); *Evans v. Frank E. Basil, Inc.*, 1986 WL 3973, at * 2 (Del. Super. 1986). The Delaware record shows clearly that the issue of adequacy of representation was not litigated during the settlement proceedings.

First, the notice to class members said nothing about adequacy of representation. Instead, the notice stated that the purpose of the settlement hearing was to determine "(a) the fairness, reasonableness, and adequacy *of the terms of the . . . Settlement*, and (b) whether an order and final judgment should be entered approving the proposed settlement." Supplemental Record ("SR") 354 (emphasis added). Whether the class was adequately represented by the named plaintiffs or by class counsel was not an issue noticed for hearing. Thus, absent class members were not on notice that they could have objected to the adequacy of representation at the settlement hearing.

Not surprisingly, the objectors who did appear at the settlement hearing did not litigate the adequacy of their representation. Objector Marion Minton focused solely on the issue of inadequate notice. *See* SR 375. Objector Pamela Minton de Ruiz, in her memorandum to the Chancery Court, framed her objection in terms of collusion, arguing that "[t]he second proposed settlement is collusive and should not be approved." SR 402. Likewise, the Minton objectors argued at the settlement hearing that "this two-cent settlement is collusive." SR 574. Neither of the Minton objectors focused on the much broader issue of whether representation was constitutionally adequate. *See* SR 402-09.[5] Finally, objector William A. Krupman did submit an affidavit to the Chancery Court stating that he opposed the settlement because "the purported class representatives . . . had proposed a settlement that benefitted no one but their own attorneys. They did not provide adequate representation." SR 422-23. However, this single blanket statement conflating the non-constitutional question of the fairness of the settlement with the constitutional question of the adequacy of representation hardly qualifies as "actual litigation" of the constitutional issue. Indeed, in his argument at the settlement hearing, objector Krupman did not address the constitutional adequacy of the representation, but argued only that the terms of the settlement were unfair. *See* SR 589-91.

Since the issue of adequacy of representation was never actually litigated in Chancery Court, no Delaware court

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5. Since the Chancery Court could have found that representation was inadequate without also finding that it was collusive, litigation of the collusion issue would not constitute "actual litigation" of adequacy of representation.

would attach preclusion to the issue of adequate representation of the absent class members. *See Star Enterprise*, 655 A.2d at 1211. Under § 1738, neither may we. *See, e.g., Migra v. Warren City School Dist. Bd. of Educ.*, 465 U.S. 75, 88 (1984) (White, J., concurring) (collecting cases).[6]

2

Even if adequacy of representation had actually been litigated by objectors at the fairness hearing, and even if Delaware law would allow an individual objector to bind an absentee on the issue of adequacy of representation — however improbable that might seem — we still could not

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6. It also appears that Delaware courts would not attach preclusion to the Delaware judgment because the Vice Chancellor failed to make a finding, supported by reasons and evidence on the record, that the requirements of Delaware Rule 23 were satisfied. In *Prezant v. De Angelis*, 636 A.2d 915 (Del. 1994), the Delaware Supreme Court held that a Court of Chancery is required to "articulate on the record its findings regarding the satisfaction of the Rule 23 criteria and supporting reasoning" before it approves a class action settlement. *Id.* at 925. The only mention of Rule 23 that the Chancery Court ever made in this case was contained in a *pro forma* statement supported by neither reasons nor evidence in the record. *See* Chancery Court's Order and Final Judgment, at 2 ("[I]t is hereby . . . determined that the plaintiffs in these Actions, as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class and that the maintenance of this action as a class action meets all the requirements of Rule 23(a) and (b)(3) of the Court of the Chancery"). While we need not decide the issue, we are doubtful that this *pro forma* recital satisfies *Prezant*.

give full faith and credit to such a judgment because it would violate due process of law. As the Epstein plaintiffs aptly put it, "*[o]bjectors are objectors, not class representatives.*" Reply Br. at 17-18. Binding absentees to any part of a class action judgment "is an act of judicial power," *Epstein I*, 50 F.3d at 667, and that power can only be exercised over absentees when their interests have, in fact, been adequately represented by parties lawfully authorized to represent them. *See, e.g., Richards v. Jefferson Cty., Ala.*, 116 S. Ct. 1761, 1766 (1996) ("[O]ne is not bound by a judgment *in personam* in a litigation in which he is not designated as a party . . . [except, in a class action, where he] has his interests adequately represented."). It would defy this fundamental principle of our jurisprudence to allow the due process right of absent class members to adequate representation to be litigated by random, volunteer objectors.[7]

Not surprisingly, Matsushita offers no persuasive authority in its attempt to argue against this basic principle. Some of the cases that it cites involve individual litigants, not class members. In *Durfee v. Duke*, 375 U.S. 106 (1963), for example — upon which Matsushita relies heavily — the Supreme Court held that an individual who has unsuccessfully challenged subject matter jurisdiction in an initial action can be precluded from raising the issue in a collateral attack on the judgment. *Durfee* was not a class action and says nothing about the rights of absent class members. Some of Matsushita's other cases pre-date *Philips*

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7. Absent class members are, of course, bound by a judgment on the merits of the class action issues, as for example, the fairness of the settlement.

Petroleum v. Shutts, 472 U.S. 797 (1985), the controlling Supreme Court precedent on the rights of absent class members. *See infra*, Section I.C. *See, e.g., Laskey v. International Union, United Auto., Aerospace & Agric. Implement Workers (UAW)*, 638 F.2d 954 (6th Cir. 1981). The only case Matsushita cites that offers any help on its proposition that volunteer objectors can litigate the due process rights of absent class members is *Grimes v. Vitalink Communications*, 17 F.3d 1553 (3d Cir. 1994). In *Grimes*, the Third Circuit held that objectors may litigate the due process rights of absent class members who have sufficient minimum contacts to support an exercise of personal jurisdiction over them by the forum. It reasons that, so long as an absentee has "minimum contacts" with the forum, he can be bound by the judgment without receiving *Shutts*' safeguards. *See Grimes*, 17 F.3d at 1558-59, 1560 & n.8. There is nothing in *Shutts*, however — or in any other case — to suggest that *Shutts* offers protection only to those absentees who are beyond the *in personam* reach of the forum. Because *Grimes* conflates the requirements of *in personam* jurisdiction with the due process safeguards that *Shutts* guarantees to absent class members, we respectfully decline to follow it.

Finally, Matsushita raises the alarmist cry that it will sound the death knell to finality in class actions if individual objectors cannot bind absentees on the issue of adequate representation. *See* Appellees' Br. at 2. We of course reject this hyperbole. So does Delaware. In *Prezant v. De Angelis*, 636 A.2d 915 (Del. 1994), the Delaware Supreme Court points out that prudent class action defendants can protect themselves from collateral attack. Although they cannot

foreclose a subsequent collateral action absolutely, they can minimize the risk by asking for a judicial finding, supported by reasons and evidence in the record, that the plaintiffs' "due process right to adequate representation has been satisfied." *Prezant*, 636 A.2d at 925-26. Such a finding will "help insure" that judgments will be subject to collateral attack only under extraordinary circumstances like those that exist in this case. *See id.* Thus, we disagree with Matsushita that finality of settlements will come to an end if volunteer objectors are not vested with the authority to bind absentees on the issue of the adequacy of class representation.

To repeat, "[o]bjectors are objectors, not class representatives." Reply Br. at 17-18 (emphasis removed). The individual objectors who voluntarily appeared at the fairness hearing were not authorized by the absentees to represent their interests, nor were they certified by the state to do so. Their appearance at the hearing did not bind anyone but themselves to an adjudication of adequacy of representation.

C

Finally, Matsushita argues that because of the procedures used in the Delaware Chancery Court, the Epstein plaintiffs cannot bring a collateral attack on adequacy of representation. This argument comes in two parts. First, Matsushita argues, the settlement hearing provided a "full and fair opportunity" for absentees to contest the adequacy of their representation. Appellees' Br. at 25. The absentees had a duty to intervene in that hearing if they wished to protect their rights, Matsushita claims, and having failed to

do so, they are estopped from bringing a collateral challenge. Second, and more broadly, Matsushita argues that the procedures Delaware had in place foreclose us from *ever* hearing a collateral challenge to adequacy of representation. Matsushita argues that we are limited to reviewing the sufficiency of the *procedures* that Delaware had in place to ensure adequate representation, rather than the adequacy of the representation itself. "[T]he Chancery Court's adherence to Rule 23 procedures satisfies the Due Process Clause as a matter of law," Matsushita continues, and an absent class member's claim on "the merits" of inadequate representation "is far outside the scope of the [collateral] review permitted by . . . the case law of this Court." Appellee's Br. at 30. We agree with the Epstein plaintiffs that both of these arguments are meritless.

1

Matsushita argues that class members who wish to contest adequacy of representation must intervene during the course of the class action proceedings and do battle with their own representatives in an adversarial contest over the way they are discharging their fiduciary duties. This argument ignores the clear teaching of *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1984), that a class member is not required to do anything during the course of a class-action proceeding. He is free to sit it out, assured that he will be bound by the result if, but only if, the proceeding comports with the special due process requirements designed to safeguard the interests of absent class members. As the Court put it in *Shutts*, "Unlike a defendant in a normal civil suit, an absent class-action plaintiff is not required to do anything.

He may sit back and allow the litigation to run its course, *content in knowing that there are safeguards provided for his protection.*" *Id.* at 810 (emphasis added). Those "safeguards", as enumerated in *Shutts*, are (1) "notice," (2) "an opportunity to be heard and participate in the litigation," (3) "an opportunity to remove himself from the class" by opting out, *and* (4) "adequate represent[ation]" "*at all times.*" Id. at 812 (emphasis added). Thus, *Shutts* admonishes absent class members that they will be bound by the merits of a judgment — including the fairness of a court-approved settlement — if it is a product of adequate representation and their other due process safeguards. But *Shutts* promises in return that they need not monitor this proceeding from afar: if the litigation culminating in the judgment violated their due process rights, then absent class members will not be bound by it.

Gonzales v. Cassidy, 474 F.2d 67 (5th Cir. 1973) — a precursor to *Shutts* — is square authority against Matsushita's intervene-or-be-estopped argument. In *Gonzales*, the Fifth Circuit rejected the very argument that Matsushita now urges upon us: "[The defendants] advance an estoppel-type argument to support the proposition that [the absent class member] cannot raise the inadequate representation issue [on collateral review]. Their position is that [the absent class member] is estopped to attack the judgment because he should have intervened." *Id.* at 76.

In rejecting this argument and holding that an absent class member may collaterally attack a judgment on the ground that he was not adequately represented, the Fifth Circuit reasoned that the question "whether counsel's

conduct of the entire suit was such that due process would not be violated by giving res judicata effect to the judgment in that suit," *id.* at 74, "*necessarily requires a hindsight approach.*" *Id.* at 73 n.11 (emphasis added). As the court went on to say, "The purpose of Rule 23 would be subverted by requiring a class member who learns of a pending suit involving a class of which he is a part to monitor that litigation to make certain that his interests are being protected . . . ." *Id.* at 76.[8]

A hypothetical based on the facts of our case serves to illustrate the common sense soundness of *Shutts* and *Gonzales* and the impracticality of Matsushita's argument that the Epstein plaintiffs are now estopped from challenging the adequacy of representation because they failed to intervene at the fairness hearing. Suppose a class member did appear as an objector at the hearing and challenged the fairness of the settlement on the ground that it had not taken into account the claim that a $21-million payment to Sheinberg was in reality a premium for his stock. *See infra*, Section II.B.2. Suppose further that the objector produced evidence in the form of deposition testimony and documents — perhaps discovered in a parallel federal class action — casting doubt on the real purpose of the $21-million payment. Suppose still further that Delaware counsel had never heard of the $21-million payment before the objector reported it at the fairness hearing.

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8. Delaware's class action provision is modeled after its federal counterpart. *Compare* Del. Chancery Court Rule 23 *with* Fed. R. Civ. Proc. 23. *See also Hoffman v. Cohen*, 538 A.2d 1096, 1098 (Del. 1988) ("[T]he construction of [the Federal Rules of Civil Procedure] by the federal judiciary is of great persuasive weight in the construction of the [Delaware Rules].") (citation omitted).

Appendix B

The question is: how should class counsel have responded to this new evidence about the Sheinberg payment during the middle of the fairness hearing, given their fiduciary duty to look after the interests of all members of the class? The obvious answer would seem to be to ask the Vice Chancellor to continue the fairness hearing until they had a chance to learn more about the Sheinberg payment and consider its potential settlement value. After all, if there was evidence to prove that the $21-million payment was a premium to get Mr. Sheinberg to support the tender offer, it would take only a simple calculation to determine that other shareholders would be entitled to a substantial recovery. *See infra*, Section II.B.2.

Let us suppose, however, that for whatever reason — perhaps the irresistability of a quick fee on claims they could not litigate — counsel stuck to their guns and got the proposed settlement — 2¢ per share (less attorneys fees) — approved and cast into a judgment. Could the law possibly be that all the class members who failed to intervene at the fairness hearing are estopped from challenging the judgment collaterally on the ground that they were not provided adequate representation? Common sense as well and *Shutts* and *Gonzales* dictate that the answer must be that they are not.

This dilemma is the driving force behind *Gonzales*' reasoning. The impracticality of assessing the adequacy of ongoing representation "live-time" is the very reason that the Fifth Circuit in *Gonzales* insisted that the challenge must be conducted with a "hindsight" approach, as on collateral review. Matsushita attempts to turn this around and limit

Gonzales' scope to cases in which it was "impossible to raise" the constitutional claim in the original proceeding. See Appellees' Br. at 35-26 ("*Gonzales* also turns on the impossibility of participation in the original proceeding. . . . *Gonzales* thus stands for the limited proposition that [collateral attack is limited to] due process violations that could not have been presented in the rendering court prior to the entry of judgment.").

This is not what *Gonzales* held. On the contrary, it held that even claims that were not "impossible" to have been raised in the initial proceedings are entirely appropriate for collateral review:

> To answer the question whether the class representatives adequately represented the class so that the judgment in the class suit will bind the absent members of the class requires a two-pronged inquiry: (1) did the trial court in the first suit correctly determine, initially, that the representative would adequately represent the class? and (2) Does it appear, after the termination of the suit, that the class representative adequately protected the interest of the class?

Gonzales, 474 F.2d at 72.

To hold otherwise — with respect to either prong of the inquiry — would be to require absent class members to monitor the proceedings in order to secure their rights to adequate representation. Absent class members are not required to bear this burden. *See Shutts*, 472 U.S. at 810;

Gonzales, 474 F.2d at 76 ("The [adequate representation safeguard] would be subverted by requiring a class member . . . to monitor the litigation . . . ."). They may rest secure in the knowledge that they can attack the judgment in a subsequent action if their due process rights are in fact violated. "Due process of law would be violated for the judgment in a class action suit to be res judicata to the absent class members unless *the court applying res judicata* can conclude that the class was adequately represented in the first suit." *Gonzales*, 474 F.2d at 74 (citing *Hansbury v. Lee*, 311 U.S. 32 (1940)) (emphasis added).[9] Indeed, to permit such a due process challenge to be definitively resolved in the initial proceeding would effectively permit an initial court to pronounce the preclusive effect of its own judgment. *See Matsushita*, 116 S. Ct. at 888 (Ginsburg, J., concurring in part and dissenting in part) ("A court conducting an action cannot predetermine the res judicata effect of the judgment; that effect can be tested only in a subsequent action.") (citing 7B *Charles A. Wright, Arthur R. Miller & Mary Kay Kane, Federal Practice and Procedure* § 1789, at 245 (2d ed. 1986)).

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9. Matsushita offers yet another argument in its attempt to foreclose us from making this assessment. It claims that, because we are a *federal* tribunal, § 1738 forecloses us from reviewing the adequacy of the representation afforded absent class members in a *state* proceeding, even though another state court would be able to hear the claim. The Supreme Court has rejected this argument. *See Kremer v. Chemical Construction Corp.*, 456 U.S. 461, 482 (1982) ("A state may not grant preclusive effect in its own courts to a constitutionally infirm judgment, and other state *and federal* courts are not required to accord full faith and credit to such a judgment.") (emphasis added) (footnote omitted).

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In adopting *Gonzales*' reasoning (and rejecting Matsushita's spin on it), we bring our circuit into line with settled law that forecloses Matsushita's intervene-or-be-estopped theory. As the Court stated in *Shutts*, "an absent class-action plaintiff is not required to do anything." *Shutts*, 472 U.S. at 810. Rather, it is the prerogative of absentees to remain just that: *absent* from a proceeding in which they are "parties" only virtually, through their class representatives. The "continuing solicitude for their rights" entitles absent class members to refrain from intervening, "content in knowing that there are safeguards provided for [their] protection." *Id.* at 810. By forcing an absent class member to monitor a proceeding and intervene to challenge the adequacy of representation that he is still in the process of receiving would defeat the purpose of having such safeguards. As Justice Ginsburg further made clear in her separate opinion in *Matsushita*: "[An absent class member] may avoid being bound *either* by appearing in the action before rendition of the judgment *or by attacking the judgment by subsequent proceedings*." *Matsushita*, 112 S. Ct. at 888 (Ginsburg, J., concurring in part and dissenting in part) (first emphasis in original, second emphasis added) (quoting Restatement (Second) of Judgments § 41, Comment a, p. 394); *see also* 18 *Charles A. Wright, Arthur R. Miller & Edward H. Cooper, Federal Practice and Procedure* § 4455, at 479 (1981) ("[Adequate representation] ordinarily is . . . determin[ed] in defining any class that is certified. *The question remains open to redetermination in a subsequent action*, however, since nonparties can be bound only if some party adequately represented their interests.") (emphasis added); *Gonzales*, 474 F.2d at 76 (absent class member has no duty to monitor class action proceeding); *cf. Martin v.*

Wilks, 490 U.S. 755, 762-65 (failure to intervene did not estop non-parties from suing parties to consent decree that adversely affected their interests).

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Matsushita attempts to avoid *Shutts* by arguing that *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461 (1982) prevents absentees from ever collaterally challenging adequacy of representation when the forum state uses a procedure like Delaware Chancery Court Rule 23. This attempt gets Matsushita nowhere. We reiterate the fundamental principle that *Shutts* established: absent class members have a right to adequate representation "at all times," and they have no duty to intervene in the initial proceeding in order to protect that right. *Shutts*, 472 U.S. at 812. There is nothing in *Kremer* to the contrary.

In *Kremer*, the Court reaffirmed the bedrock principle that a judgment must satisfy the requirements of due process in order to receive full faith and credit. In the specific case before it, the Court held that a New York administrative proceeding was entitled to full faith and credit because the procedures it employed satisfied due process. Matsushita argues that *Kremer* likewise limits absent class members to a "procedures only" approach when they seek to challenge adequacy of representation. It points to passages in *Kremer* that ask whether the New York administrative proceeding provided the "minimum procedural requirements" of due process. *Kremer*, 461 U.S. at 481. It then argues that the mere existence of Rule 23 satisfies the "minimum procedural requirements" for protecting adequacy of representation.

That being so, Matsushita concludes, *Kremer* never permits a collateral challenge that alleges that absent class members *in fact* received inadequate representation.

We categorically reject this simplistic application of *Kremer* to the class action context. The Court fashioned *Kremer*'s "procedures only" approach to apply to collateral challenges of judgments in traditional litigation, where individual parties are bound by virtue of their *presence* before the court. *Kremer* was not a class action and did not address the special due process problems of binding persons not parties to the action. *Shutts*, in contrast, which was a class action, held that absentees have a right to adequate representation "at all times," 472 U.S. at 812, and that they need not intervene to enforce that right. No procedure can reliably protect an absent plaintiff who does not *in fact* have an adequate representative in court championing his cause. The Court recognized this salutary principle in *Hansbury v. Lee*, 311 U.S. 32 (1940), and it has never retreated from it. *See id.* at 41-42 ("members of a class not present as parties to the litigation may be bound by the judgment where they are *in fact* adequately represented") (emphasis added).

Nonetheless, Matsushita argues, the absent class members in this case received notice, an opportunity to be heard (at the objection hearing), and the right to opt out of both the class action proceeding and the proposed settlement. Surely, Matsushita complains, these protections fully satisfied the "minimum procedural requirements" of *Kremer*, and due process does not require anything more.

The Supreme Court, however, could not have been more clear in requiring more. Indeed, if settled law defeats

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Matsushita's contention that absent class members have a duty to intervene or be estopped from challenging the adequacy of their representation, then this contention faces a veritable fortress of authority. In *Shutts*, the Court echoed the language of *Kremer* when it laid out the "minimum procedural due process protection" due to absent class members, including "adequate represent[ation]" "at all times." *Shutts*, 472 U.S. at 811-12. In addition to *Shutts*, the case law is consistent that adequate representation *in fact* is required to bind absent plaintiffs. *See Richards v. Jefferson Cty.*, 116 S. Ct. 1761, 1766 (1996); *Matsushita*, 116 S. Ct. at 885 (Ginsburg, J., concurring in part and dissenting in part); *Hansbury*, 311 U.S. at 41-43; *Crawford v. Honig*, 37 F.3d 485, 487 (9th Cir. 1994); *Brown v. Ticor Title Ins. Co.*, 982 F.2d 386, 390 (9th Cir. 1992); *Class Plaintiffs v. City of Seattle*, 955 F.2d 1268, 1278 (9th Cir. 1992); *In re Real Estate Title and Settlement Services Antitrust Litig.*, 869 F.2d 760, 769 (3d. Cir. 1989); *see also* Restatement (Second) of Judgments §§ 41 & 42 (1982); 18 Charles A. Wright, Arthur R. Miller, and Edward H. Cooper, Federal Practice and Procedure § 4455, at 477 (1981) ("Adequate representation [in fact] is required to support preclusion by judgment in a class action.").

None of the cases cited by Matsushita offer support for its position that absent class members who receive notice and a chance to opt out of a settlement are foreclosed from challenging adequacy of representation. Matsushita places particular reliance upon two Ninth Circuit cases — *Torrisi v. Tucson Electric Power Co.*, 8 F.3d 1370 (9th Cir. 1993), and *Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173 (9th Cir. 1977). Neither of these cases speak to the rights of *absent*

class members, however; they involve challenges by persons who represented themselves before the court in class action proceedings.

Torrisi involved a direct appeal of a settlement judgment by class members who chose to participate in the trial court proceedings as objectors to the settlement, rather than resting on their *Shutts* right to be represented as absentees. *See Torrisi*, 8 F.3d at 1370, 1375 n.2 (9th Cir. 1993) (noting that litigants filed objections, opposed settlement, and "participated in the settlement hearing and argued against approval of the settlement"). Thus, *Torrisi* stands for the unremarkable proposition that class members who choose to protect their interests by intervening in the trial court proceedings — instead of relying on the representation of class counsel — are bound to the resulting judgment and may not get a second bite at the apple by attacking it collaterally. *See also Matsushita*, 116 S. Ct. at 888 (Ginsburg, J., concurring in part and dissenting in part) ("[T]he represented person may avoid being bound *either* by appearing in the action before rendition of judgment *or* by attacking the judgment by subsequent proceedings.").

Torrisi does not discuss or even allude to the rights of absent class members. Indeed, *Torrisi* does not even cite *Shutts*, the leading authority on the due process rights of absent class members. Faced with the task of explaining this omission, Matsushita attempts to distinguish *Shutts* from *Torrisi* on the ground that *Shutts* did not involve a settlement, but rather an adjudication of a class action. Matsushita fails to cite a single case in support of its argument that *Shutts*' requirement of adequate representation "at all times," *Shutts*,

472 U.S. at 812, may be diluted in class settlement proceedings. Nothing in *Shutts* suggests a "sub-class" of settlement class actions in which class members are only entitled to lesser due process protections, and we see no principled basis for so limiting *Shutts*. Quite to the contrary, Matsushita's argument regarding settlement class actions was rejected by the Supreme Court in *Amchem Products v. Windsor*, 117 S. Ct. 2231 (1997).

In *Amchem*, the Court reviewed a settlement class action certified by the Third Circuit in asbestos litigation. In the course of its analysis, the Court held that the safeguards designed for the protection of absent class members — including adequate representation — "demand undiluted, even heightened, attention in the settlement context." *Id.* at 2248. As the Court explained, such heightened attention is necessary because a court that certifies a class for the purpose of settling claims rather than litigating them will "lack the opportunity, present when a case is litigated, to adjust the class, informed by the proceedings as they unfold." *Id.* at 2248. Moreover, to collapse absentees' right of adequate representation into their right to review and opt out of the settlement would be to "substitute for Rule 23's certification criteria a standard never adopted — that if a settlement is "fair," then certification is proper." *Id.* at 2249. "Federal courts . . . lack authority" to make such a substitution. *Id.* *See also Prezant*, 656 A.2d at 924 (rejecting proposition that notice and opt out rights, without adequate representation, satisfy due process for settlement class actions). Matsushita's attempt to read into *Torrisi* a reduced standard of protection for absentees in settlement class actions is foreclosed by *Amchem*.

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Matsushita also cites *Holiday Magic* for the proposition that notice and opt out rights may substitute for the right of absent class members to adequate representation in a settlement class action. *Holiday Magic*, however, is inapposite for the same reason as *Torrisi*: it did not involve absent class members. As did *Torrisi*, *Holiday Magic* involved an appeal of a class settlement judgment by class members who appeared in the trial proceedings — in this case, as parties to the original action. *See Holiday Magic*, 550 F.2d at 1175 ("Appellants . . . filed as cross-plaintiffs [below]."). In *Holiday Magic*, our court addressed and rejected the *merits* of the appellants' claim that they had been inadequately represented. *See id.* at 1176-79. It then added — in dictum, and over the objection of then-Judge Anthony Kennedy — that it did not think that individuals who had an opportunity to opt out of the settlement after receiving notice of its terms should be allowed to "play the role of spoilers for a class of more then 31,000 people" by challenging the validity of the entire settlement on grounds of inadequate representation. *Id.* at 1177; *see also Holiday Magic*, 550 F.2d at 1179-80 (Kennedy, J., concurring) (agreeing that representation was in fact adequate but rejecting suggestion of majority that opt-out rights can substitute for adequate representation). To the extent that the panel was concerned by the prospect that an uncertified class member could forcibly bind the entire class to the result of his own claim of inadequate representation, we agree, and have held that individual objectors may not bind anyone but themselves on that issue. *See supra*, Section I.B.2.[10]

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10. In any event, *Holiday Magic* was superseded by *Shutts*, which is now the controlling authority on the rights of absent class (Cont'd)

All the other cases that Matsushita cites in support of its position suffer from similar problems. Many involve *individual* litigation and do not speak at all to the rights of absent class members. *See, e.g., Kremer*, 456 U.S. at 461; *Durfee v. Duke*, 375 U.S. 106 (1963); *Osborn v. Ashland Cty. Bd. of Alcohol, Drug Addiction & Mental Health Svcs.*, 979 F.2d 1131 (6th Cir. 1993). Some are like *Torrisi* — class actions in which the collateral attack was launched by class members who appeared and represented themselves in the initial action. *See, e.g., Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29 (1st Cir. 1991); *Sandler Assoc. v. BellSouth Corp.*, 818 F. Supp. 695 (D. Del. 1993), *aff'd*, 26 F.3d 123 (3d Cir. 1994). And some are like *Holiday Magic* — they pre-date *Shutts*, the controlling authority on the due process rights of absent class members. *See, e.g., Laskey v. UAW*, 638 F.2d 954 (6th Cir. 1981). None speaks authoritatively to the rights of absent class members who claim inadequate representation by their class fiduciaries.

In sum, neither caselaw nor common sense supports Matsushita's position that the mere existence of procedures like Rule 23 can foreclose an absentee from receiving his day in court on the issue of adequacy of representation. Rather, the established practice of our circuit is exemplified

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members. To the extent that *Holiday Magic* is inconsistent with *Shutts*, we must, of course, follow the latter. *See Catli v. Catli*, 999 F.2d 1405, 1408 n.5 (9th Cir. 1993) ("Although we must ordinarily adhere to Ninth Circuit precedent, we may reexamine that precedent without the convening of an en banc panel where our precedent has been nullified by a subsequent Supreme Court decision.") (citation omitted).

by *Brown v. Ticor Title*. In that case, we entertained the merits of a collateral challenge by absent class members to adequacy of representation, stating unequivocally that "if the plaintiff was not adequately represented in the prior action or there was a denial of due process, then the prior decision has no preclusive effect." *Brown v. Ticor Title Ins. Co.* at 390 (citing *Hansbury v. Lee*, 311 U.S. 32 (1940)). Matsushita simply cannot overcome the settled law that absent class members need not do anything during the course of the proceeding, "content in knowing that there are safeguards provided for [their] protection," including the requirement that they be "adequately represented" "at all times." *Shutts*, 472 U.S. at 811-12.

II

We now turn to the merits of the adequacy of representation issue. Following the model provided by *Gonzales*, we conduct a "two-pronged inquiry," *Gonzales*, 474 F.2d at 72.[11] First, we determine whether there was a disabling conflict of interest between Delaware counsel and the MCA shareholders who tendered their shares. Second, we review the actual conduct of Delaware counsel in

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11. In *Brown v. Ticor Title Ins. Co.*, 982 F.2d 386 (9th Cir. 1992), our Circuit adopted *Gonzales*' model for conducting an analysis of adequacy of representation (although distinguishing *Gonzales*' result), with one additional requirement. We held that, on collateral attack, "a party must show . . . that the opposing party was on notice of facts making [the alleged inadequacy of the representation] apparent." *Id.* at 390-91. In this case, that requirement is easily met, as Matsushita was on notice of all the information in the record on which we base our analysis.

discharging their fiduciary duty to protect the interests of those shareholders. *See id.* at 72-77.

A

The essence of the Epstein plaintiffs' position on the claimed conflict of interest is that the Delaware settlement was the product of a one-sided bargaining process because their representatives went to the table with no credible bargaining power. Not surprisingly, Matsushita makes no serious attempt to challenge this position, relying almost exclusively on their arguments as to why we cannot reach the merits. *See* Appellees' Br. at 41-44. It is axiomatic that a plaintiff's power to negotiate a reasonable settlement derives from the threat of going to trial with a credible chance of winning. As the Supreme Court has said, permitting class-action settlements in which class counsel are disabled from litigating the case renders:

> both class counsel and court . . . disarmed. Class counsel confined to settlement negotiations could not use the threat of litigation to press for a better offer, see Coffee, Class Wars: The Dilemma of the Mass Tort Class Action, 95 Colum. L.Rev. 1343, 1379-1380 (1995), and the court would have to face a bargain proffered for its approval without the benefit of adversarial investigation, see, *e.g.*, *Kamilewicz v. Bank of Boston Corp.*, 100 F.3d 1348, 1352 (C.A.7 1996) (Easterbrook, J., dissenting from denial of rehearing en banc) (parties "may even put one over on the court, in a staged performance"), cert. denied, 520 U.S. __, 117 S.Ct. [sic] 1569, 137 L.Ed.2d 714 (1997).

Amchem, 117 S. Ct. at 2248-49 (1997) (per Ginsburg, J.); *see also Kamilewicz*, 100 F.3d at 1352 (Easterbrook, J., joined by Posner, C.J., and Manion, Rovner, and Diane P. Wood, JJ., dissenting from denial of rehearing en banc) ("The lawyers support the settlement to get fees; the defendants support it to evade liability; the court can't vindicate the class's rights because the friendly presentation means that it lacks essential information.")."

The Delaware class plaintiffs and their counsel could not carry out a threat to litigate the federal claims in this case, and Matsushita knew it.

The inability of the class representatives to exercise any leverage on behalf of the Epstein plaintiffs was the result of three basic facts. First, they could not litigate the federal claims because Congress has said that Exchange Act claims may not be litigated in state courts. Thus, the claims that Matsushita violated SEC Rule 14d-10 by paying premiums to Messrs. Wasserman and Sheinberg were not and could not have been pleaded in the Delaware action. Moreover, there was no discovery on those claims; indeed, the Delaware plaintiffs probably were *unable* to conduct any discovery on the federal claims because the facts relevant to those claims had no apparent relevance to the subject matter of the state law claim that the MCA directors had breached their fiduciary duties in failing to maximize shareholder value upon a change of corporate control. *See Epstein I*, 50 F.3d at 659; Del. Chancery Court Rule 26(b)(1). Finally, Matsushita would have had reason to discount the value of any settlement made with the state plaintiffs against the risk that a state court judgment releasing Exchange Act claims would not survive

a collateral attack on the ground that the Delaware courts had no jurisdiction to release exclusively federal claims especially in light of the absence of any overlapping issues of fact between the state and federal claims. *See Epstein I*, 50 F.3d at 662-65.[12] Matsushita must have recognized that it would subject itself to a substantial risk by settling the federal claims in state court rather than federal court, and would have had to discount its bottom line in the state settlement negotiations accordingly. The denouement was predictable: Matsushita used its infinitely superior bargaining power vis-a-vis the state class representatives to settle the Exchange Act claims at a rock bottom price.[13]

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12. We note that this additional factor, though instructive in giving a full picture of the relative bargaining strength of the parties in this case, is not necessary to our holding that Delaware counsel's representation of the Epstein plaintiffs was inadequate.

13. Indeed, it would not be an exaggeration to say that the Delaware plaintiffs were kept in state court entirely at the sufferance of Matsushita. As we discuss below, the Delaware Vice Chancellor, in rejecting the first settlement, determined that the state law claims were "extremely weak" and had "little or no value" because no such state cause of action existed. *See In re MCA Shareholders Litigation*, 598 A.2d 687, 694 (Del. Ch. 1991); *infra*, Section II.B.2. Matsushita could have, but did not move the Chancery Court to dismiss the state action. Rather, it chose to use it as a vehicle for seeking an inexpensive release of the federal claims. *See also* 18 *Charles A. Wright, Arthur R. Miller & Edward H. Cooper, Federal Practice and Procedure* § 4470, at 526 (Supp. 1997) ("In approving the settlement, the Delaware Vice Chancellor observed that the defendants seemed more bent on escaping potential liability under federal law than on avoiding state-law claims that the Vice Chancellor had earlier characterized as extremely weak.").

Second, the class representatives not only lacked the bargaining power that comes with a credible threat of going to trial and winning, they also lacked the ability to make a credible threat that they could put Matsushita at risk by going to trial on the state claims and proving facts material to the federal claims that would be binding upon Matsushita through issue preclusion. Because the state and federal claims shared no common issues of material fact, a judgment on the state claims could not be used as an "offensive" estoppel in future litigation of the federal claims. *See Epstein I*, 50 F.3d at 665-55. While the Delaware class representatives lacked the muscle to put Matsushita at risk on the federal claims, the existence of their state class action, however worthless standing alone, served to provide Matsushita with an opportunity to try to get rid of the federal claims at a bargain basement price. If the parties could get court approval of a settlement that released the federal claims, Matsushita would have at least a fair shot of using the judgment to block the federal action with a full faith and credit argument. That is, of course, exactly what Matsushita did as soon as the judgment became final. We had the Epstein plaintiffs' appeal of the district court's summary judgment under submission when Matsushita notified us of the Delaware settlement judgment and argued that we should give it preclusive effect.

Third, Matsushita had a further bargaining advantage, quite apart from its knowledge that the Delaware plaintiffs could not put it at risk on the federal claims. Matsushita also knew that class counsel had an extraordinary incentive to settle and settle *quickly* because that was the *only* way they could extract a fee out of the federal claims. Class counsel could not benefit from the federal claims by going to trial

for the obvious reason that the federal claims could not be litigated in state court. Moreover, the pendency of a parallel action in federal court — the *Epstein* case — meant that Delaware class counsel were at risk of being "beaten to the punch" and getting no return on the federal claims at all. Matsushita knew that it was negotiating a release of the federal claims with class counsel who could not litigate those claims and whose self-interest gave them an incentive to settle and settle fast.

What all this demonstrates is that there was a jarring misalignment of interests between class counsel and members of the federal class. It was plainly in the best interest of counsel to settle the federal claims at any price. For them, any settlement was better than no settlement because settlement was the only way they could make any money on the federal claims — indeed, given that the state claims were essentially worthless, it was the only way that Delaware counsel could get any compensation at all. Delaware counsel were not, after all, serving as *pro bono* counsel to the MCA shareholders who tendered their shares.

It was not, in contrast, in the best interest of the clients — the MCA shareholders — to settle their Exchange Act claims at any price. Their interest lay in settling those claims for a sufficient amount to make it imprudent to take the risk of litigation. That risk, of course, would have to be realistically assessed in terms of the chances of prevailing on either or both of their claims that Matsushita had violated SEC Rules 10b-13 and 14d-10 in paying premiums to Messrs. Wasserman and Sheinberg. Indeed, the misalignment of interests and incentives between class counsel and their

clients in these extraordinary circumstances was so great that it is fair to say that counsel's interests were more in line with the interests of Matsushita than those of their clients.

This was not the adequate representation of absent class members that due process requires "at all times." *Shutts*, 472 U.S. at 812. As we have said, "An adequate representative must . . . be free from economic interests that are antagonistic to the interests of the class." *Larson v. Dumke*, 900 F.2d 1363, 1367 (9th Cir. 1990). The interests of Delaware counsel in this case were nothing but antagonistic to the interests of the MCA shareholders who tendered their shares. As a result of the three factors described above, which make this case extraordinary on its facts, Delaware counsel's overriding economic interest lay in settling the federal claims at any price and winning the race to judgment. The interests of the MCA shareholders who tendered their shares, in contrast, lay in pursuing those claims vigorously and either obtaining a reasonable settlement or litigating the claims in federal court. Their interests certainly did not lie in agreeing to a settlement that gave the attorneys a $1,000,000 fee but nothing for themselves — the settlement originally proposed by Delaware counsel — nor in agreeing to a settlement of 2¢ per share, inclusive of attorneys' fees — the settlement Delaware counsel ultimately persuaded the Vice Chancellor to approve. The inability of Delaware counsel to litigate the federal claims, their further inability even to obtain a judgment on the state law claims that could have had issue preclusive effect on the federal claims, and the pendency of a competing parallel class action in federal court caused the economic interests of Delaware counsel to be fundamentally "antagonistic to the interests" of the Epstein plaintiffs. *Id.*

Appendix B

As we have previously said — and as pure common sense dictates — "Adequate representation . . . depends on . . . an absence of antagonism." *Brown v. Ticor Title Ins. Co.*, 982 F.2d 386, 390 (9th Cir. 1992). Here, there is no question that there was antagonism between the interests of the lawyers and the interests of their clients. That antagonism made their representation of the MCA shareholders who tendered their shares inadequate as a matter of law.

B

In addition to the argument that Delaware counsel had a disabling conflict of interest, the Epstein plaintiffs contend that the actual conduct of Delaware counsel in settling the federal claims fell far short of the representation that due process requires. Rather, they claim, Delaware counsel completely failed to investigate or develop their federal claims and basically "rolled over" during settlement negotiations, ultimately entering into a settlement that was essentially worthless except for their own fees. This course of conduct, they conclude, falls well below the level of representation that is required to bind absentees. We agree.

Adequate representation requires that counsel "vigorously and tenaciously protect[ ] the interests of the class." *Gonzales*, 474 F.2d at 75. "Vigorous" and "tenacious" protection requires, at a minimum, that counsel pursue their clients' claims, make a reasonable effort to assess the fair settlement value of those claims, and pursue a settlement that approximates that value, always taking into account the ever-present risks of litigation. The inadequacy of Delaware counsel's representation is brought into sharp focus by their

vigorous *disparagement* of the federal claims throughout the course of the settlement proceedings. Indeed, Delaware counsel's representation of those claims surpassed inadequacy and sank to the level of subversion. Counsel consistently sought to convince, not only their clients, but their adversaries and the Chancery Court itself that the federal claims had no merit. They repeatedly and summarily dismissed those claims as "frivolous" without ever conducting any discovery or any meaningful analysis of the legal issues, much less presenting the claims in a favorable light. *See* SR 171-72. In sharp contrast, the Epstein counsel earnestly pursued those same claims in federal court, recognizing their merit and successfully demonstrating that merit in persuading this court to reverse an adverse summary judgment ruling below. This contrast makes it all the more clear that Delaware counsel's representation of the MCA shareholders who tendered their shares fails even the most minimal standards of adequacy.

1

Barely fifteen days after the Epstein counsel filed a class action in federal court on the exclusively federal claims, Delaware counsel negotiated the release of those claims. This first Delaware settlement proposed to release all claims, state and federal, arising out of the Matsushita-MCA merger, in exchange for $1 million *in attorney fees*, *no* monetary compensation for shareholders, and an amended poison pill provision of dubious value. *See Epstein I*, 50 F.3d at 660; SR 75-76. In its notice to the class members regarding this settlement, Delaware counsel explained that the plaintiffs in the federal action alleged that Matsushita had violated SEC

Rule 14d-10 by offering Wasserman different and more valuable consideration for his shares than it offered to other tendering shareholders.[14] In recommending the settlement of those claims, counsel told their clients that "the substantial benefits the plaintiffs and the other members of the Class can expect to receive by virtue of the Settlement" outweighed "the risks, burdens and costs of continued litigation . . . [and the] uncertainties relating to proof of the allegations contained in the various actions." SR 76. Counsel put no flesh on this bare-bones analysis. In particular, they never explained why litigation of the state law claims would put the federal claims at "risk." Moreover, the notice for the settlement hearing offered no defense of the proposition that the benefits of the settlement were "substantial" in relation to the value of the federal claims it released. Rather, the notice merely assured class members that counsel had conducted "extensive investigation of the facts and examination of the law involved," SR 76, and had concluded that the settlement was fair. It is hard to imagine what Delaware counsel meant by an "extensive investigation," since the record shows no discovery at all on the facts underlying the federal claims. Indeed, this lack of discovery is hardly surprising. As discussed above, Delaware counsel were probably disabled from developing the federal claims through traditional discovery, since discovery in state court was limited to matters relevant to the subject matter of the state claims — that the MCA directors had violated their fiduciary duty to attempt to secure a better deal than the one

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14. At the time of the hearing on the first settlement proposal, the Epstein plaintiffs had not yet pled the Sheinberg claim. They did so some time after the Vice Chancellor rejected the first proposed settlement.

Matsushita offered the shareholders. *See* Del. Chancery Court Rule 26(b)(1); *supra*, Section II.A.

Indeed, the record is clear that Delaware counsel had not conducted an extensive investigation into the merits of the federal claims in order to determine their fair settlement value. Delaware counsel admitted to the Chancery Court that they had reviewed the Wasserman claim "relatively quickly" before concluding that the claim was "frivolous" and would be "a waste of our time." SR 171-72. In fact, in their cursory review, Delaware counsel simply adopted two of the defenses raised by *Matsushita* in federal court. First, Delaware counsel took Matsushita's position that claims under Rule 14d-10 should be limited to actions taken within a rigidly defined "tender offer period." SR 123-28; *see also Epstein I*, 50 F.3d at 653-54. Matsushita had claimed that this "pure timing" rule allowed it to give additional consideration to Wasserman by timing the exchange of his stock to occur immediately after Matsushita's acceptance for payment of all other shares tendered. *See Epstein I*, 50 F.3d at 653. Delaware counsel accepted Matsushita's "pure timing" rule uncritically and used it to disparage the Wasserman claim. SR 123-28.

Second, Delaware counsel agreed with Matsushita's position that the Wasserman agreement did not violate Rule 14d-10 because Wasserman actually received "substantially less than the cash consideration received by MCA's other stockholders." SR 129. Once again, the record shows no discovery activity at all. Instead, Delaware counsel simply accepted at face value Matsushita's position that "the Wasserman deal was less valuable than that provided to the other shareholders in the form of cash." SR 185. Epstein

counsel, in contrast, produced evidence and expert testimony in arguing that Wasserman's deal was structured in order to confer upon him considerable tax benefits, and that the after-tax value that Wasserman would receive was actually much greater than the value of the tender offer to the average shareholder. *See Epstein I* Appellants' Br. at 15-16, 55.

Despite the best efforts of Delaware counsel to disparage the Exchange Act claims of the absentees they were "representing," the Chancery Court rejected the first settlement because the Wasserman claim had "significant value" while the state law claims had "little or no merit." *In re MCA Shareholders Litig.*, 598 A.2d at 690. On the merits of the federal claim, the Chancery Court was far from convinced that Delaware counsel's pure timing rule controlled: "This issue has not yet been definitively addressed by the courts and therefore this [Rule 10b-13] claim . . . clearly has arguable merit." *Id.* at 695.[15] In addition, the Chancery Court refused to accept Delaware counsel's uncritical account of the value of Wasserman's deal: "Although it is claimed that the value of the consideration given to Wasserman had less value than the cash offered to the other stockholders, the true economic value of the Wasserman consideration is uncertain." *Id.* at 695.[16] In light

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15. Matsushita offered no authority and not much reasoning in support of this hypertechnical rule, while we offered reasons and contrary authority for rejecting it in a five page analysis. *See Epstein I*, 50 F.3d at 653-57.

16. In the summary judgment proceedings in federal district court, Matsushita did not controvert the allegation in the Epstein

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of the "substantial merit" of the Wasserman claim, the court held that it would be unfair to release all federal claims in a settlement that offers "no real monetary benefit to the Class" but awards the attorneys $1 million in fees. *Id.* at 695-96. The court dismissed the value of the revised poison pill provision as "illusionary [sic]." *Id.* at 696.

2

The record of the Delaware action shows no activity for the ten months following April 25, 1991. The case lay dormant until the district court in Los Angeles entered summary judgment on February 10, 1992.[17] *See* SR 625. During the same interval, Epstein counsel were vigorously pursuing the federal claims, as demonstrated by over ten pages of docket entries in district court. *See* SR 803-13. Eight months later, Delaware counsel agreed to settle the

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plaintiffs' complaint that Wasserman's consideration had a greater per share value than that received by other shareholders. The Epstein plaintiffs produced evidence on this issue, *see Epstein I*, 50 F.3d at 657 n.9, and we left the issue open for redetermination on remand, *see id.* at 657.

17. Matsushita also exhibited a curious degree of inaction during this period. Specifically, following the Chancery Court's determination that the state claims had "little or no merit," *In re MCA*, 598 A.2d at 690, Matsushita did not take the action that would seem to have been most advisable and move the Chancery Court to dismiss the claim. While we do not rest our holding in this case on any finding that there was collusion between Matsushita and Delaware counsel, we note the Chancery Court's comment that "suspicions abound." *In re MCA Shareholders Litigation*, 1993 WL 43024 (Del. Ch.) (Feb. 16, 1993), at *5.

exclusively federal claims for the sum of $2 million — a bare 2¢ a share, *inclusive* of attorney fees. *See* SR 352, 356. In advocating the second settlement to the class and the Vice Chancellor, Delaware counsel continued to disparage the federal claims. They rested their disparagement primarily on the position that the district court's entry of summary judgment was "dispositive as to [the federal claims'] lack of substantial merit." SR 460. They failed to point out, however, that the Ninth Circuit affords no deference to a district court's decision on summary judgment, but reviews such determinations *de novo*. *See, e.g.*, *Bagdadi v. Nazar*, 84 F.3d 1194, 1197 (9th Cir. 1996). Nor did Delaware counsel make any effort to assess the likelihood of reversal by the Ninth Circuit. They merely reiterated *Matsushita*'s arguments in an effort to convince the Chancery Court once again that the federal claims were worthless. In fact, *Delaware counsel specifically urged the Chancery Court "not [to] delve into the ultimate merits of [the federal] claims upon appeal as if it were reviewing de novo the dismissal*," but instead that it treat the district court's decision as "dispositive." SR 460.

Delaware counsel argued without explanation that it was "doubtful" that the Ninth Circuit would reverse the district court to hold either that there is a private right of action under Rules 10b-13 and Rule 14d-10, or to reject Matsushita's strict timing rule. SR 461-64. They urged the Chancery Court to give the dismissal of the federal claims "presumptive effect." SR 553. Counsel claimed to have "reviewed the law and . . . reviewed the briefs and . . . looked at the findings of fact"[18]

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18. A district court does not, of course, make "findings of fact" in ruling on a summary judgment motion. Findings of fact are made

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in the federal action before determining that the federal claims were "so fraught with uncertainty, that those claims are so weak, that the record in that proceedings . . . is so horrendous, that the prospect of anything emerging from that case is so remote, that $2 million more than adequately compensates — much more than adequately compensates for the release of all the federal and state claims." SR 555-56.[19] Without citing any caselaw regarding private rights of action under Rule 10b-13 or Rule 14d-10, Delaware counsel reasoned that, as a general matter, the Supreme Court and the Ninth Circuit had drastically narrowed the bases upon which private rights will be implied under any statute. *See* SR 461. Based on these generalizations and their reading of Rule 10b-13 and the implementing statute of Rule 14d-10,

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on the basis of evidentiary hearings and usually involve credibility determinations, which explains why they are reviewed deferentially under the clearly erroneous standard. *See* Fed. R. Civ. Proc. 52(a). As we have said, summary judgments are reviewed *de novo* by the Ninth Circuit.

19. Similarly, in their notice to the class members, Delaware counsel used the same boilerplate language found in the first notice of settlement, claiming that they had conducted "extensive investigation of the facts and examination of applicable law," and that they recommended settlement "after considering (i) the substantial monetary benefits that [class members] will receive pursuant to the Settlement; . . . [and] (iii) the attendant risks and delays of continued litigation." SR 353. Once again, counsel did not identify the "risks" involved in litigating the state law claims, nor did they explain why the benefits of settlement were "substantial," especially in relation to the value of the federal claims. *See supra*, Section II.B.1.

counsel concluded that the "weight of authority" suggested that neither Rule 10b-13 nor Rule 14d-10 authorizes a private right, SR 461-62, and characterized the federal claims as "lacking in substantial merit." SR 546.

Counsel's "analysis," however, disregarded two cases, from the Second and Third Circuits, that are square holdings that there is a private right of action under Rule 14d-10. *See Polaroid Corp. v. Disney*, 862 F.2d 987, 991, 997 (3d Cir. 1988); *Field v. Trump*, 850 F.2d 938, 946 (2d Cir. 1988). Counsel's failure to report these cases to class members and to the Vice Chancellor is even more astonishing given that they actually cited *Field* on the issue of the timing of the Wasserman transaction. For counsel not to cite *Field* on the private right of action issue, or to cite *Polaroid* at all, is inexcusable. Needless to say, Epstein counsel cited these cases to us on appeal, *see Epstein I* Appellants' Br. at 52-55, and we followed them and brought the Ninth Circuit into line with the Second and Third Circuits, finding that a private right of action does exist under Rule 14d-10. *See Epstein I*, 50 F.3d at 652.

Delaware counsel also stated without explanation that the Ninth Circuit was "unlikely" to overturn the district court's holding that the Wasserman transaction took place after the expiration of the tender offer period, or that Wasserman did not receive greater consideration for his shares than the other MCA shareholders received. *See* SR 464-67. Once again, counsel declined to mention that we would review the district court's summary judgment rulings *de novo*. As it did in the first settlement proceedings, counsel accepted without question Matsushita's self-serving valuation of the Wasserman deal, stating in a conclusory

fashion that the "lack of negotiability and relative risk" of Wasserman's preferred stock "more than sufficiently outweigh whatever tax benefits Wasserman may have derived." SR 467. Without discussing whether the value of the Wasserman consideration might present a genuine issue of fact, counsel simply stated that the district court's decision regarding the timing and value of the Wasserman transaction "would seem most unlikely to be overturned on appeal." SR 465.

Finally, to cap off their disparagement of their clients' Exchange Act claims, Delaware counsel asserted generally that the federal claims should not stand in the way of settlement because "damages on the federal claims are highly uncertain." SR 468. Counsel simply ignored the obvious: that damages on the Sheinberg claim, at least, were both easily calculable and uncontested. Matsushita paid Sheinberg $21 million in addition to the $66 in cash per share of MCA stock that it paid other shareholders. When divided by the number of shares that Sheinberg tendered, this $21-million payment would equal a premium of $17.80 per share. *See Epstein I*, 50 F.3d at 657. Thus, a simple calculation of $17.80 multiplied by the total number of shares outstanding — approximated as 78,000,000, *see* SR 556, 568-69 — would yield damages of about $1.4 billion on a successful Sheinberg claim. Even so, counsel stuck to its strategy of disparaging the federal claims in their effort to get the Vice Chancellor to approve the settlement that would produce them a fee.

In fact, there is not a single mention of the $21 million-payment to Sheinberg in Delaware counsel's memoranda or arguments to the Chancery Court. *See* SR 458-70; SR 538-63; 591-99. In their representations to the court concerning

the pending federal action, Delaware counsel stated only that the federal complaint "alleg[ed] that the arrangement whereby defendant Wasserman exchanged his MCA stock for preferred stock in the merged entity (1) violated SEC Rule 10b-13 . . . and (2) violated SEC Rule 14d-10." SR 439-40. They did not even mention the claim on the $21 million payment that had been pleaded in the Epstein plaintiffs' amended complaint.

It is clear, however, that Delaware counsel was aware of the Sheinberg claim. Counsel described that claim, if only briefly, in their notice to the class members as "a payment to defendant Sheinberg, which defendants asserted was . . . incentive compensation," SR 346, but which plaintiffs alleged was a "covert premium . . . designed to induce Sheinberg to tender his shares." *Epstein I*, 50 F.3d at 657. In contrast, Epstein counsel learned about the $21 million payment and investigated it, questioning both Wasserman and Sheinberg about it at their depositions. *See Epstein I* ER 357, Ex. V:51-53 (deposition of Wasserman), Ex. W:193-95 (deposition of Sheinberg). Their answers revealed that no MCA board documents prior to the date of the tender offer referred to any such payment to Sheinberg. *See id.*[20]

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20. Matsushita and MCA have contended that Sheinberg was entitled to incentive compensation for past services in the form of stock options, but the Epstein plaintiffs discovered that the minutes of MCA's board meetings contained no reference to any such stock options to Sheinberg prior to the time Matsushita made its tender offer. The evidence that does exist shows the payment to Sheinberg was to be made two days after Matsushita accepted the MCA shares for payment and that Matsushita approved the agreement to make the payment. *See Epstein I*, 50 F.3d at 657-59.

Epstein counsel relied in part on this evidence to argue the existence of a genuine issue of material fact and convince this court to reverse the summary judgment on this claim. *See Epstein I*, 950 F.3d at 658; *Epstein I* Appellants Br. at 32 (citing Wasserman and Sheinberg depositions conducted by Delaware counsel). Yet, despite the $17.80 per share value of the Sheinberg claim if a trier of fact were to find that the $21 million was a premium paid to induce Sheinberg to support the tender offer and not incentive compensation for past services, Delaware counsel stood mute on the claim while urging the Vice Chancellor to approve the settlement of $2 million, or 2¢ per share, inclusive of attorneys fees. Once again, the conduct of Delaware counsel in the performance of their fiduciary duties was inexcusable.

In sum, the only "vigorous" and "tenacious" work, *Gonzales*, 474 F.2d at 75, that Delaware counsel performed on behalf of the Epstein plaintiffs was to convince the Chancery Court to adopt their adversary's position and view the federal claims as essentially worthless. This was not merely "inadequate" representation, it was hostile representation that served the interests of counsel in getting a fee, but did not serve the interests of the MCA shareholders in getting a settlement based upon a thorough and fair assessment of their Exchange Act claims. To bind the Epstein plaintiffs to the Delaware judgment under these circumstances would violate their due process right to have their interests adequately represented at all times.

III

The Epstein plaintiffs also contend that we may withhold full faith and credit from the Delaware judgment because

the Vice Chancellor did not adequately supervise the settlement proceedings. They argue that adequacy of judicial supervision is intricately bound up with adequacy of representation and, hence, that it rises to the level of a due process requirement. *See* Appellants' Br. at 31-37. In effect, they argue that we should add adequacy of judicial supervision to the four safeguards that *Shutts* guarantees to absent class members.

The Epstein plaintiffs cite no authority for their argument, however. They merely point us to various cases, including *Epstein I*, that have spoken in general terms about the importance of the court's role in supervising a class action proceeding. *See Epstein I*, 50 F.3d at 667; *In re General Motors Pick-Up Fuel Tank Prod. Liab. Litigation*, 55 F.3d 768, 805 (3d Cir.), *cert. denied*, 116 S. Ct. 88 (1995) (describing "fiduciary responsibility" of courts in class actions); *Prezant*, 636 A.2d at 921 (stressing "fiduciary nature of the class action"). Because we hold that the absent class members were denied due process because of inadequate representation, we need not reach this novel constitutional question.

CONCLUSION

Our decision that the Delaware judgment deprived the Epstein plaintiffs of their due process rights to adequate representation is the product of an extraordinary set of circumstances. Delaware counsel suffered from a conflict of interest: they could not litigate the Exchange Act claims of the absent class members, could not extinguish those claims by the issue preclusive effect of a judgment based

upon the state claims, and were in competition with a parallel class action in federal court which threatened to destroy their chances of securing a fee. Not surprisingly, their conduct in the Delaware action reflected this disabling conflict. Delaware counsel disparaged the Exchange Act claims of their own clients at every turn — to the clients themselves, to their adversaries, and even to the Chancery Court.

These extraordinary circumstances provide a sufficient answer to Matsushita's concern that our decision will pose a grave threat to the finality of class action judgments. The reality of the matter is that it is the rare exception for representation in a class action even to approach the point where an absentee will have a colorable claim for inadequacy. The small handful of cases that have come to our attention in which absentees have successfully challenged adequacy of representation bears this observation out. The paucity of such cases is to be expected. With rare exceptions, trial judges do their jobs and certify class representatives capable of representing the interests of absent class members. And, again with rare exceptions, the class representatives (including their counsel) faithfully discharge their fiduciary duties to the class. This case presents one of those rare exceptions.

We REVERSE the judgment and REMAND for proceedings consistent with Parts I, II, III, V & VI of *Epstein I*.

Appendix B

Epstein v. MCA, Inc., No. 92-55675

O'SCANNLAIN, Circuit Judge, dissenting:

Because I wholeheartedly agree with the Supreme Court's determination that the adequacy of representation issue was fully and fairly litigated and necessarily decided in the Delaware courts, I must respectfully dissent from the opinion this court announces today. In fashioning its own version of the events as they unfolded before the Delaware courts, the majority posits that the plaintiffs' adequacy claims were neither "actually litigated" before the Chancery Court nor "finally decided" by that court. With all deference, I believe that the undisputed facts tell a different story.

I

The argument urged upon us by the Epstein plaintiffs certainly engenders sympathy and has some force. Irrespective of whether the Delaware attorneys' conduct in the state court rose to the level of constitutional deprivation, their act of referring, in a single breath, to their own clients' claims as "fraught with uncertainty," "weak," and "horrendous" suggests less than dynamic advocacy. Regrettably, however, and unlike my colleagues, I do not believe that we are in a position to pass judgment on the merits of this appeal. The very issue presented to our court for decision today — whether or not the Epstein plaintiffs received constitutionally adequate representation in the Delaware courts — has been fully and fairly litigated before a state court of competent jurisdiction and finally decided by that court. Consequently, under the Full Faith and Credit Act, 28 U.S.C. § 1738, and the policies of federalism, comity, and finality that give it life, our court is not, in my mind, free simply to revisit the issue.

Appendix B

I do agree with my colleagues that the Supreme Court did not conclusively resolve the due process issue before it remanded the case to us. Indeed, as our court's opinion points out, the Supreme Court specifically disclaimed any interest in resolving the merits of the inadequacy claim. *See Matsushita Elec. Indus. Co. v. Epstein*, 116 S. Ct. 873, 880 n.5 (1996). However, the fact that the Supreme Court chose *not* to reach the due process challenge does not inexorably lead to the conclusion that this court *may* decide the issue. Quite the contrary, after reviewing the record, the Supreme Court concluded — in three separate passages and in no uncertain terms — that the Delaware courts had *already* conclusively resolved the due process issue. First, in Part I, in which it described the procedural posture of the case, the Court stated, rather matter-of-factly, that "[a]fter argument from several objectors, *the [Chancery] Court found the class representation adequate* . . . ." *Id.* at 876 (emphasis added). Several pages later, the Court reiterated its conclusion: citing the decisions of the Delaware courts approving the second MCA settlement, the Supreme Court specifically found that the Chancery Court, in accordance with Delaware Court of Chancery Rule 23, had "*determined* that the plaintiffs [,] . . . as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class." *Id.* at 880 (quoting Order and Final Judgment at 2, *In re MCA, Inc. Shareholders Litig.*, C.A. No. 11740, 1993 WL 43024 (Del. Ch. Feb. 22, 1993)) (internal quotation marks omitted) (emphasis added). Finally, in its now famous footnote five, the Court expressed its skepticism at plaintiffs' decision even to press the due process issue "*in spite of the Chancery Court's express ruling*, following argument on the issue, that the class representatives fairly and adequately

protected the interests of the class." *Id.* at 880 n.5 (emphasis added).

Consequently, it is scarcely debatable that in the eyes of the Supreme Court, the Epstein plaintiffs' due process challenge was presented to and rejected by the Delaware state courts. The trouble, I suppose, is that the majority and the Supreme Court do not share the same vision.

A

In support of its "no-actual-litigation" argument, the majority first complains that, despite the fact that the form of notice sent to class members explicitly provided the rights to opt out and to object,[1] that notice "said nothing about adequacy of representation." Slip Op. at 11. Of course, the first, most obvious, and most decisive response to the majority's complaint is that the doctrine of collateral estoppel simply does not demand that an issue be actually *noticed for* argument, only that it be actually *litigated at* argument. *See, e.g., Messick v. Star Enter.*, 655 A.2d 1209, 1211 (Del. 1995) ("The test for applying collateral estoppel requires that (1) a question of fact essential to the judgment, (2) be litigated and (3) determined (4) by a valid and final judgment." (quoting *Taylor v. State*, 402 A.2d 373, 375 (Del. 1979))). Secondly, even if lack of notice were somehow independently

1. A number of the class plaintiffs exercised their procedural rights pursuant to the notice: eighteen shareholders opted out of the class, and three class members appeared in the Delaware Chancery Court to object to the settlement. *See In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43204, at *3 (Del. Ch. Feb. 16, 1993).

relevant to a proper collateral estoppel analysis, the court's no-notice argument fails to account for the fact that the form of notice mailed to each of the class members detailed the precise terms of the settlement. The very terms of that settlement — so pungently characterized by the majority as "a bare 2¢ a share, *inclusive* of attorneys' fees" and a release of all claims, state and federal — are *prima facie* evidence that something was amiss. *See* Slip Op. at 46. That fact — that the settlement *on its face* raises eyebrows — was no less true on October 27, 1992, when the notice was mailed, than our court finds it today. Consequently, the Epstein plaintiffs "were not forced into a position of having to predict whether their interests would be adequately represented. They could determine whether there had been adequate representation of their interests by reviewing the terms of the settlement." *Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173, 1177 (9th Cir. 1977); *accord In re Four Seasons Sec. Laws Litig.*, 502 F.2d 834, 843 (10th Cir. 1974). They knew that they could object in the Delaware courts to the settlement, and, by implication, to the representation that had produced the settlement; they simply declined to do so.[2]

Closer to the heart of the appropriate collateral estoppel standard, the court claims — inexplicably, in my view — that the objectors who did elect to appear at the settlement hearing did not "actually litigate" the adequacy of their representation. To the contrary, one of the objectors, William

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2. I might add that the Epstein plaintiffs' counsel's candid admission to the Supreme Court that his clients stayed out of the Delaware proceedings for purely strategic reasons, *see infra* pages 10 - 11, is conclusive proof that any perceived notice failure was illusory.

Krupman, explicitly stated (as the majority itself acknowledges) that he opposed the settlement because "the purported class representatives . . . had proposed a settlement that benefitted no one but their own attorneys. *They did not provide adequate representation to the class.*" Affidavit of William A. Krupman at 2 - 3, *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024 (Del. Ch. Feb. 16, 1993) (emphasis added). The majority attempts to cushion the blow of Mr. Krupman's explicit statement by accusing it of "conflating the non-constitutional question of the fairness of the settlement with the constitutional question of the adequacy of representation." Slip Op. at 12. Its criticism, however, rings particularly hollow for one salient reason, alluded to briefly above: the court's *own* conclusion of inadequacy rests substantially on precisely the same logic, namely, that, *under the terms of the settlement*, the Delaware plaintiffs' attorneys who profited so well did so at the expense of their class-member clients. *See generally* Slip Op. at 37 - 52.

The majority dismisses the arguments of another of the objectors, Pamela Minton de Ruiz, out of hand because she failed to use the magic word "inadequacy." Rather, the court notes, Minton de Ruiz "framed her objection in terms of *collusion*." Slip Op. at 12 (emphasis added). The court simply brushes Minton de Ruiz's objection aside because, it complains, she did not "focus[ ] on the much broader issue of whether representation was constitutionally adequate." Slip Op. at 12. Formalistic labels and logic games[3] aside,

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3. The majority would have us read Minton de Ruiz's objection as if it belonged in a Venn diagram: "All collusion is inadequacy; some inadequacy is collusion . . . ."

however, it appears that the court has either failed to recognize *for* itself or failed *to* admit to itself that the Epstein plaintiffs bottom their inadequacy of representation argument on virtually the identical factual predicate upon which Minton de Ruiz based her "collusion" objection. For instance, the Delaware Chancery Court characterized Minton de Ruiz's argument in the following terms:

> She argues . . . that the Delaware plaintiffs have colluded with the defendants to settle this action and dispose of the supposedly meritorious federal claims in exchange for an award of attorneys' fees and a de minimis benefit to the class.

In re MCA, Inc. Shareholders Litig., Civ. A. No. 11740, 1993 WL 43024, at *3 (Del. Ch. Feb. 16, 1993). When one compares Minton de Ruiz's contention with one of the plaintiffs' central arguments from their opening brief in this appeal, the perceived distinction between "inadequacy of representation" and "collusion" quickly begins to fade:

> *Delaware counsel — paid only on a contingency basis — had no incentive other than to "compromise" other litigants' substantial federal claims.* Counsel knew that, if they settled the federal claim they would get paid; if they attempted to litigate, they would get nothing. Such a one-sided incentive structure is surely a constitutionally disabling conflict of interest . . . .

Appellants' Opening Brief at 27 (emphasis in original). And once one recognizes that even this court's *own* inadequacy

holding invokes the very same attorney-client antagonism, the majority's effort to obscure substantive identity in semantic minutiae is laid bare:

> Matsushita . . . knew that class counsel had an extraordinary incentive to settle and settle *quickly* because that was the *only* way they could extract a fee out of the federal claims.
>
> . . . .
>
> . . . Indeed, the misalignment of interests and incentives between class counsel and their clients in these circumstances was so great that it is fair to say that counsel's interests were more in line with the interests of Matsushita than those of their clients.

Slip Op. at 37 - 38 (emphasis in original). In sum, try as it may to "label away" objector Minton de Ruiz's argument, the fact remains that a rose by any other name is still a rose: in this case, as the court's opinion amply demonstrates, the primary reason that the class representatives were alleged to have been *inadequate* was the self-interested and, dare I say, *collusive*, conduct of the Delaware class attorneys.

B

In addition to holding that the inadequacy issue was not "actually litigated" in the Delaware system, this court cites *Prezant v. De Angelis*, 636 A.2d 915 (Del. 1994), and suggests that the Delaware courts did not "finally determine"

the question of inadequacy in a manner consistent with Delaware law. Slip Op. at 13 n.6. Again, I must agree with the United States Supreme Court's assessment that the available evidence counsels otherwise. In *Prezant*, the Delaware Supreme Court announced the following holding: "[I]n every class action settlement, the Court of Chancery is required to make an explicit determination on the record of the propriety of the class action according to the requisites of Rule 23(a) and (b)," including the mandate that class representation was adequate. *Prezant*, 636 A.2d at 925. Contrary to the majority's suggestion, the Vice Chancellor in this case specifically made the "explicit determination" contemplated by *Prezant*, when he declared that "it is . . . hereby determined that the plaintiffs in the Actions, as representatives of the Settlement Class, have fairly and adequately protected the interests of the Class . . . ." Order and Final Judgment at 2, *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024 (Del. Ch. Feb. 22, 1993). His "determination," I submit, could not have been more "explicit." What is more, the Delaware Supreme Court — the *very court* that issued the *Prezant* guidelines — entertained additional argument on the inadequacy matter, and expressly and unanimously affirmed the Chancery Court's determination that the class had been adequately represented. *See In re MCA, Inc. Shareholders Litig.*, No. 126,1993, 1993 WL 385041, at *1 (Del. Sept. 21, 1993).[4]

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4. The majority accuses the Delaware Chancery Court of failing properly to support its conclusion of adequacy, citing language from the *Prezant* opinion suggesting that a court should "articulate on the record its findings regarding the satisfaction of the Rule 23 criteria and supporting reasoning in order to facilitate appellate

(Cont'd)

In sum, I conclude, as did the United States Supreme Court, that the question of adequate representation (1) was actually litigated before the Delaware Chancery Court and (2) was decided by that court in a valid and final judgment. Although the plaintiffs in this action were not themselves present before the Vice Chancellor, their grievances were ably litigated through their surrogates, objectors Krupman and Minton de Ruiz. Moreover, as the settlement notice made explicit, the plaintiffs themselves were presented with a "full and fair opportunity" to participate personally in the settlement hearing if they so desired. Consequently, under long-established principles of Delaware preclusion law, I believe that the Delaware courts would give collateral estoppel effect to the Chancery Court's judgment and would forbid plaintiffs from relitigating the merits of the inadequacy issue. *See Messick v. Star Enter.*, 655 A.2d 1209, 1211 (Del.

(Cont'd)
review." *Prezant*, 636 A.2d at 925. Even if I believed that the quoted language represented the holding of the Delaware Supreme Court — which I do not, *see Goodrich v. E.F. Hutton Group, Inc.*, 681 A.2d 1039, 1045 (Del. 1996) (reaffirming that the "essential" requirement recognized in *Prezant* is "a judicial determination that the adequate representation requirement of Rule 23(a)(4) has been satisfied") — I believe that the Chancery Court discharged its responsibility of articulating the reasons for its holding; it found that although the objectors had alleged that the settlement was collusive, "[s]uspicion . . . is not enough." *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024, at *5 (Del. Ch. Feb. 16, 1993); *see also Youngman v. Tahmoush*, 457 A.2d 376, 381 (Del. Ch. 1983) (suggesting that, under Delaware law, the party challenging the adequacy of the class members' representation bears the burden of demonstrating inadequacy). That finding was specifically affirmed by the Delaware Supreme Court.

1995); *Evans v. Frank E. Basil, Inc.*, 1986 WL 3973, at *2 (Del. Super. Ct. Mar. 20, 1986). Pursuant to the plain — and now universally acknowledged — meaning of the Full Faith and Credit Act, 28 U.S.C. § 1738, we must do the same. *See Matsushita*, 116 S. Ct. at 877 ("The Act . . . directs all courts to treat a state court judgment with the same respect it would receive in the courts of the rendering state."); *accord Marrese v. American Academy of Orthopedic Surgeons*, 470 U.S. 373, 380 (1985); *Migra v. Warren City Sch. Dist.*, 465 U.S. 75, 81 (1984); *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 481 - 82 (1982); *Allen v. McCurry*, 449 U.S. 90, 96 (1980).

II

As to the majority's last-gasp invocation of *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985), to deny the Delaware judgment issue preclusive effect, I most emphatically protest. The court cites *Shutts* in support of its per se rule that class settlement objectors — such as Krupman and Minton de Ruiz — may never, consistent with the Due Process Clause, finally litigate absent class plaintiffs' rights to adequate representation. *Shutts* simply cannot, in my view, bear the weight of such an extreme interpretation.[5] The concerns that impelled the *Shutts* Court's recognition of the prerogative of absent plaintiffs generally to "sit back and allow the litigation to run its course," *Shutts*, 472 U.S. at 810, plainly are not in play in this case.

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5. It is certainly worthy of note, in this respect, that the majority itself recognizes that the Third Circuit's recent, post-*Shutts*, decision in *Grimes v. Vitalink Communications Corp.*, 17 F.3d 1553 (3d Cir. 1994), patently rejects such view. Slip Op. at 15.

Appendix B

The *Shutts* Court was motivated by a concern for fairness to parties who, without the right to "sit back," might be forced to forfeit their claims altogether. The *Shutts* Court found that in light of financial constraints, some plaintiffs, if forced to litigate their own claims, might "have no realistic day in court." *Id.* at 809. However, as the following colloquy, which occurred during oral argument before the Supreme Court, makes clear, the Epstein plaintiffs (quite unlike the "absent" class plaintiffs in *Shutts*) absented themselves from the Delaware fairness hearing not for *financial* reasons, but for *tactical* reasons:

> [COURT]: What about the argument that you should have come into Delaware to make [the inadequacy of representation] objection and not stayed out of it?
>
> [COUNSEL]: . . . If we stayed out . . . we knew that we could make collaterally the attack on lack of adequate representation [and] due process . . . .

Transcript of Oral Argument at 47, *Matsushita Elec. Indus. Co. v. Epstein*, 116 S. Ct. 873 (1996) (No. 94-1809). What is more, the Epstein plaintiffs lost absolutely nothing by not attending the settlement hearing. As they sat idly by, content in the notion that they had preserved their right collaterally to attack the Delaware judgment, their substantive arguments were, as detailed above, simultaneously being presented by objectors Krupman and Minton de Ruiz. (Indeed, this fact very likely was known to the Epstein lawyers, in light of objector Krupman's lawyer's admission that his client's

objection had originally been drafted by the attorneys representing the Epstein plaintiffs.)

The Epstein plaintiffs have managed, quite literally, to have their cake and eat it too. They now get two bites at the proverbial apple. Today, this court not only *condones* such gluttony, it *constitutionalizes* it. We are constantly reminded that "no single model of procedural fairness, let alone a particular form of procedure, is dictated by the Due Process Clause." *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 483 (1982). Rather, "due process is flexible and calls for such procedural protections as the particular situation demands." *Morrissey v. Brewer*, 408 U.S. 471, 481 (1972). For the court to have co-opted the salutary principle announced in *Shutts* and applied it in rote fashion to the facts of this case undermines, in my view, the very concept of due process of law.

III

The majority seeks to hush Matsushita's "alarmist cry" that the opinion announced today "will sound the death knell to finality in class actions if individual objectors cannot bind absentees on the issue of adequate representation." Slip Op. at 15. The court rejects Matsushita's argument as "hyperbole." Slip Op. at 15. To allay Matsushita's fears, the court directs its attention to the following passage in the Delaware Supreme Court's opinion in *Prezant*:

> [The approach we announce today] will serve to benefit both class members and defendants. Class members . . . will . . . have their interests

> protected by the requirement that their claims cannot be compromised without . . . a judicial determination that the Rule 23 criteria have been satisfied . . . . Such a determination will include a finding that their due process right to adequate representation has in fact been satisfied. Defendants will be protected from a possible collateral attack on the validity of the settlement by a class member claiming the settlement did not meet the requirements of Rule 23. This protection will help insure that the final release sought by defendants in settlements is indeed final.

Prezant, 636 A.2d at 925 - 26. I sincerely doubt that the court's reassurance is of any consolation whatsoever to Matsushita or to other potential class action defendants. If anything, it is a source of consternation. Matsushita, after all, did precisely what the *Prezant* court (and now this court) instructed it to do: It asked for and got a judicial finding — an "express ruling," in the words of the United States Supreme Court — that the representation of the plaintiff class had been constitutionally adequate. Curiously, today this court tells both Matsushita and the Delaware judiciary that, alas, they did not do enough.

Because I believe that today's decision not only threatens finality, but also contravenes "the elementary principles of federalism and comity," *Growe v. Emison*, 507 U.S. 25, 35 (1993), that animate the Full Faith and Credit Act, I respectfully dissent.

APPENDIX C — MEMORANDUM OPINION OF THE COURT OF CHANCERY OF DELAWARE, NEW CASTLE COUNTY DATED AND FILED FEBRUARY 16, 1993

In re MCA, INC. SHAREHOLDERS LITIGATION.

Civ. A. No. 11740.

Court of Chancery of Delaware, New Castle County.

Submitted: Jan. 21, 1993.

Filed: Feb. 16, 1993.

* * *

MEMORANDUM OPINION

HARTNETT, Vice Chancellor.

After considering all the circumstances, the Court in its business judgment approves the settlement of this class action. That has the effect of barring related federal securities law claims that have been filed in federal district court in California. The settlement is approved because the Court finds, on balance, that it is in the best interests of the class to settle this litigation and the terms of the settlement are fair and reasonable — although the value of the benefit to the class is meager.

Appendix C

This decision also awards attorneys' fees to the attorneys for plaintiffs in an amount less than that sought.

I

This is the second time a proposed settlement of this class action has come before this Court. The facts appear in greater detail in this Court's previous opinion in which the initial proposed settlement was rejected. See In re MCA, Inc. Shareholders Litigation, Del.Ch., 598 A.2d 687 (1991).

In September of 1990, Matsushita Electrical Industrial Co., Ltd. ("Matsushita") and MCA, Inc. publicly announced that they were negotiating a possible acquisition of MCA by Matsushita. During the next two days, three purported class action suits were filed against MCA and its directors. Notwithstanding that no acquisition agreement had been reached, the complaints alleged that the defendants had breached their fiduciary duty to the shareholders by failing to implement a market check procedure to ensure that maximum shareholder value was realized. These actions were consolidated by an Order of this Court dated October 2, 1990.

On November 26, 1990, MCA and Matsushita announced that they had entered into a Merger Agreement. Under the Merger Agreement, Matsushita agreed to make a cash tender offer for all of MCA's outstanding shares at $66 per share and agreed to spin off Pinelands, an MCA subsidiary, which controlled a television station which Matsushita, under federal law, was forbidden to acquire.

On December 3, 1990, a purported class action was filed in the United States District Court for the Central District of

California as Epstein v. MCA, Inc. et al., No. CV-90-6451-R ("the Epstein action"). The Epstein action alleged that the tender offer included a special deal for the acquisition of the approximately 5 million shares of MCA held by Lew R. Wasserman, MCA's chairman and CEO. Wasserman had agreed with Matsushita to exchange his shares for a special class of preferred stock in a Matsushita subsidiary.

The complaint in the Epstein action alleged that this transaction violated SEC Rule 10b-13, 17 C.F.R. 240.10b-13, that prohibits purchases by a tender offeror outside a tender offer during the pendency of the offer and also violated the "all holders, best price" rule in SEC Rule 14d-10, 17 C.F.R. 240.14d-10. Four additional purported class actions alleging similar claims were also filed in the California Federal District Court and were consolidated by Order of the District Court on April 1, 1991.

The plaintiffs in this Delaware action amended their complaint on December 14, 1990 to allege that the tender offer materials failed to disclose the preferential treatment allegedly given to Wasserman. The amended complaint also named Matsushita as a defendant since it allegedly aided and abetted MCA in a breach of fiduciary duty by entering into the transaction with Wasserman. The amended complaint did not allege the breaches of federal securities laws asserted in the Epstein action, however, because such claims are within the exclusive jurisdiction of the federal courts.

On December 18, 1990, the parties in this Delaware action filed a Stipulation and Agreement of Compromise and Settlement and this Court provisionally certified the Class

pursuant to Chancery Rule 23(b)(2) for settlement purposes only. David and Andrew Minton (purported shareholders of MCA) entered an appearance and objected to the proposed settlement on the sole basis that the settlement, if approved, would release the claims asserted in the Epstein action without affording the members of the class the opportunity to opt out of the class and continue to press the claims in the Epstein action.

This Court held that while the proposed settlement need not provide for an opt-out, it could not be approved. This Court found that the claims asserted in this Delaware action were "at best, extremely weak, and therefore, ha[d] little or no value. It further found that the federal securities law claims in the California action raised issues that had not been definitively addressed by the courts and that those claims therefore clearly had arguable merit and, therefore, some value. MCA, 598 A.2d at 695. This Court observed that it must carefully scrutinize any settlement that would have the effect of barring claims of at least arguable merit that were not raised in Delaware litigations but were asserted elsewhere, particularly if a proposed settlement was of little or no value to the class. Id., (citing Selfe v. Joseph, Del.Supr., 501 A.2d 409 (1985)).

After this Court evaluated the proposed settlement under this standard, the settlement was rejected as being unfair to the class. Id. at 696. While the proposed settlement provided for a generous payment of up to $1 million in attorneys' fees, the only benefit proposed to be received by the class would have been a cosmetic change in a poison pill in Pinelands, a subsidiary of MCA. Id. at 695-96. In exchange

for this "illusionary" benefit, the class would surrender any potential benefits from the claims in the Epstein action which this Court found to be "the only claims which have any substantial merit . . . ". Id. at 696. Therefore, the proposed settlement was rejected.

On April 1, 1991, the California Federal District Court rejected the plaintiffs' motion for class certification in the Epstein action and a second motion for class certification was rejected on September 3, 1991. By Order dated August 13, 1991, the same court dismissed the SEC Rule 10b-13 claims on the basis that there is no private right of action under that provision. Finally, on February 10, 1992, the Federal District Court granted summary judgment to defendants on the SEC Rule 14d-10 claims on the basis that the Wasserman transaction did not take place within the tender offer period and that Wasserman did not receive a greater consideration than other shareholders. The Epstein plaintiffs have appealed these decisions to the United States Court of Appeals for the Ninth Circuit. On December 17, 1992, that court denied the request of the Epstein plaintiffs to expedite their appeal because of the pendency of the settlement in this Court.

The parties in this Delaware action have now submitted a second settlement proposal. If this proposed settlement is approved, the class will receive $2,000,000 in cash less any award of attorneys' fees. Any class member dissatisfied with the settlement may opt out of the class. This settlement, like the previous proposed settlement, is a "global settlement;" that is, it would bar not just the claims asserted in this Delaware action but all related claims such as those asserted in the Epstein action.

Appendix C

At the settlement hearing, counsel for the plaintiffs in this Delaware action reported that 18 class members had opted out of the class. In addition, objections to the proposed settlement were received from three class members.

Pamela Minton de Ruiz, daughter of one of the Epstein plaintiffs, objected on the basis that the settlement is collusive. She argues, without any direct evidence of collusion, that the Delaware plaintiffs have colluded with the defendants to settle this action and dispose of the supposedly meritorious federal claims in exchange for an award of attorneys' fees and a de minimis benefit to the class. She argues that the opt out is virtually meaningless because, as a practical matter, "few shareholders will avail themselves of it". She makes this argument despite that her brothers, David and Andrew Minton, as objectors to the first proposed settlement, strongly argued in favor of the same opt-out provision.

Objector William A. Krupman makes arguments similar to those made by Pamela Minton. Objector Marion Minton, wife of one of the Epstein plaintiffs, also objects to the adequacy of the notice of the settlement given to members of the class because Dean Witter apparently delayed transmitting the notice of the settlement hearing to the owners of shares held in street name by Dean Witter.

II

Chancery Rule 23(e) requires that the Court review proposed settlements of class action suits. The rule is "intended to guard against surreptitious buy-outs of

representative plaintiffs, leaving other class members without recourse." Wied v. Valhi, Inc., Del.Supr., 466 A.2d 9, 15 (1983), cert. denied, 465 U.S. 1026 (1984). This Court must be particularly careful in reviewing a proposed settlement that has the effect of barring claims of at least arguable merit that are not asserted in Delaware but are being asserted in another forum. MCA, 598 A.2d at 695; see also, John C. Coffee, Jr., "Suspect Settlements In Securities Litigation" N.Y.L.J., March 28, 1991, p. 5.

This Court's role in reviewing a proposed settlement is to exercise its discretion and to "apply its own business judgment in deciding whether the settlement is reasonable . . .". Polk v. Good, Del.Supr., 507 A.2d 531, 535 (1986). The factors to be considered in making this determination include:

> (1) the probable validity of the claims, (2) the apparent difficulties in enforcing the claims through the courts, (3) the collectability of any judgment recovered, (4) the delay, expense and trouble of litigation, (5) the amount of the compromise as compared with the amount and collectability of a judgment, and (6) the views of the parties involved, pro and con. Id. at 536 (citations omitted).

Particular attention must be paid to balancing the value of all the claims being compromised against the value of the benefit to be conferred on the class. MCA, 598 A.2d at 691. After weighing the factors present here, the Court concludes that this settlement, notwithstanding that it has meager value

to the class, should be approved as being in the best interests of the class.

As noted in the previous opinion in this case, the claims brought in this Delaware action were "extremely weak and, therefore, have little or no value." Id. at 694. At that time, the federal claims had not been litigated and raised issues which had not been "definitively addressed by the courts." Id. at 695. This Court therefore was reluctant to approve the settlement that would compromise those claims, despite their somewhat limited merit, particularly when the benefit to be received in exchange was of "illusionary" value to the class. Id. at 696.

Now, however, there has been a full hearing on the federal claims and those claims have been rejected on both legal and factual grounds in the U.S. District Court. The Objectors claim that these rulings are erroneous and that there is at least a chance that they will be reversed in a pending appeal. These federal claims, however, obviously now have less economic value than they had before their dismissal.

In determining whether a settlement should be approved, a court should not try the merits of the underlying claims. MCA, 598 A.2d at 691. This principle would seem to be especially appropriate where the underlying claims, like the federal claims here, are outside the jurisdiction of this Court.

It is sufficient that the determination of the federal district court that the claims lack merit must be accorded substantial weight in determining the present settlement value of those claims.

Appendix C

In exchange for surrendering the weak claims asserted in this Delaware action and the federal claims which, in light of the adverse federal district court decision, now have greatly diminished settlement value, the class will receive a $2 million cash settlement (less any award of attorneys' fees). As the Objectors point out, this amounts to only two to three cents per share. While not a munificent recovery, on balance, the Court finds in its business judgment that it is adequate (if only barely so) to support the proposed settlement.

This conclusion is based on the Court's conclusion that the claims on appeal from the federal district court now have minimal economic value and that there is a provision to opt-out of the settlement although only eighteen requests for opt-outs were received from the more than 25,000 shareholders notified.

The availability of the right to opt-out of the class protects the ability of class members who find the proposed settlement inadequate to continue the district court litigation.

The three Objectors assert, without citing any empirical evidence, that because, as a practical matter, few small shareholders will ever opt-out of a settlement, the proposed settlement will in effect destroy the Epstein action as a class action. This argument comes from an unexpected source because the Mintons (two of the three Objectors to this settlement) objected to the first proposed settlement solely on the grounds that it did not incorporate an opt-out provision. In any case, this Court's role is to evaluate the economic value of the settlement in its business judgment and not to speculate on why shareholders opt-out of class actions.

Appendix C

The Objectors also argue that this Court should delay its ruling until the Ninth Circuit renders its decision on the appeal of the Epstein action. This Court is most reluctant to take any action that could be construed as attempting to interfer with the appellate process in the federal courts. However, as noted above, the Ninth Circuit denied the Epstein plaintiffs' motion for expedited argument after being advised of the proposed settlement hearing in this Court and there is no indication of when that court might rule. If this Court rejects the settlement, the $2 million dollar benefit will vanish.

The law favors voluntary settlements. In re Resorts International Shareholders Litigation Appeals, Del.Supr., 570 A.2d 259, 265-66 (1990). Unless fair settlements are promptly approved, the settlement process will be adversely impacted. Therefore, the Objectors' request that this Court indefinitely delay its review of the settlement must be denied.

Objector Marion Minton also objects to the settlement on the basis that many shareholders whose shares were held in "street names" by Dean Witter did not receive timely notice. However, the uncontradicted evidence is that the responsibility for any delay rests with Dean Witter. A shareholder who holds her shares in a "street name" assumes responsibility for any delays in notice that are attributable to the delay attendant in forwarding notice through the "street name". Enstar v. Senouf, Del.Supr., 535 A.2d 1351, 1354-55 (1987). Nonetheless, as a matter of equity, the proposed order implementing this opinion shall be amended to provide that any opt-outs received after the deadline set forth in the settlement notice but before the date of this decision will be effective.

Finally, the Objectors argue that the proposed settlement is collusive. They argue that the defendants "cut a deal" with the plaintiffs and their attorneys in this Delaware action to achieve a settlement of the federal claims which plaintiffs and their attorneys in this litigation were unable to assert (but can only settle) instead of negotiating with the Epstein plaintiffs and their attorneys whom they allege understand the true fair value of those federal claims.

The potential for this type of abuse clearly exists in representative litigation. See Stepak v. Tracinda Corp., Del.Ch., C.A. No. 8457-NC, Allen, C. (Aug. 18, 1989), slip op. at 15-16. And when the settling parties have previously proposed a patently inadequate settlement in which the class would have received no monetary benefit but the attorneys would have received $1 million in fees (as the initial, now-rejected, settlement provided), suspicions abound. Suspicion, however, is not enough and the Objectors have offered no evidence of any collusion. The proposed settlement must therefore be approved.

III

Plaintiffs' attorneys have applied for a total of $691,057.68 in attorneys' fees and expenses which represents approximately 35% of the settlement fund of $2 million.

The law governing the award of attorneys' fees in corporate litigation is well-established in Delaware. Where the efforts of a plaintiff on behalf of the stockholders of a corporation result in the creation of a common fund or the conferring of a corporate benefit, the Court may, in its

discretion, award attorneys' fees. Tandycrafts, Inc. v. Initio Partners, Del.Supr., 562 A.2d 1162, 1164 (1989).

The factor usually accorded the greatest weight in a discretionary award of attorney fees is the benefit produced by the litigation. I/M of the Appraisal of Shell Oil Co., Del.Ch., C.A. No. 8080-NC, Hartnett, V.C. (Oct. 30, 1992); In re Maxxam Group, Inc. Stockholders Litigation, Del.Ch., C.A. No. 8636-NC, Allen, C. (Apr. 16, 1987), slip op. at 31. "In many, perhaps most, cases it will be clear that the entire benefit is directly and entirely attributable to the litigation." Id. However, if the Court determines that the benefit was partly caused by the shareholder litigation and partly caused by the activities of others the award of attorneys' fees will be reduced. Id. at 31-34; Aaron v. Parsons, Del.Supr., 144 A.2d 155 (1958); Dow Jones & Co. v. Shields (In re Telerate, Inc. Shareholders Litigation), Del.Ch., C.A. No. 11,115-NC, Hartnett, V.C. (March 4, 1992).

In this litigation, the defendants' willingness to create the settlement fund seems likely to have been motivated as much by their concern as to their potential liability under the federal claims as by their concern for liability under the state law claims which this Court characterized as "extremely weak". MCA, 598 A.2d 694. Therefore, although this Delaware action may be the vehicle under which the more meritorious federal claims are settled, this does not mean that the Delaware action was entirely responsible for the benefits produced.

Even if this litigation was responsible for the production of the entire settlement fund, plaintiffs' application for 35%

of that fund is excessive considering the factors set forth in Sugarland Industries, Inc. v. Thomas, Del.Supr., 420 A.2d 142 (1980). In addition to the value of the benefit, this Court must also consider the stage at which the litigation was concluded and the amount of work necessary to produce the benefit. I/M of the Appraisal of Shell Oil Co., Del.Ch., C.A. No. 8080-NC (Consolidated), Hartnett, V.C. (Oct. 30, 1992), slip op. at 19-20 (citing Sugarland Industries, Inc. v. Thomas, Del.Supr., 420 A.2d 142 (1980)). While plaintiffs' counsel allegedly expended in excess of 3,300 hours in connection with this litigation, in cases involving shareholder litigation similar to this action, "[t]his Court has properly awarded much less than 25% of the benefit, especially where cases have been settled long before trial." Id. at 20 (citations omitted).

Ultimately, the amount of attorneys' fees that should be awarded is left to the informed discretion of this Court. See Tandycrafts, Inc. v. Initio Partners, Del.Supr., 562 A.2d 1162, 1166 (Chancery Court has "plenary power" over allowance of attorneys' fees). Having considered all the factors discussed in Sugarland, especially the meager benefit achieved by the litigation, the stage at which the proceeding was ended, the time and effort of counsel, the relative complexities of the litigation, the contingency factor and the standing and ability of counsel — I find that plaintiffs should be awarded a total of $250,000 in attorneys' fees and expenses.

IV

The settling parties shall submit an amended proposed order.

APPENDIX D — EXCERPTS FROM OFFICIAL TRANSCRIPT PROCEEDINGS OF THE SUPREME COURT OF THE UNITED STATES DATED NOVEMBER 27, 1995

IN THE SUPREME COURT OF THE UNITED STATES

No. 94-1809

MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD., ET AL.,

Petitioners

v.

LAWRENCE EPSTEIN, ET AL.

Washington, D.C.
Monday, November 27, 1995

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 11:03 a.m.

* * *

[3] PROCEEDINGS

(11:03 a.m.)

* * *

Appendix D

ORAL ARGUMENT OF BARRY R. OSTRAGER ON BEHALF OF THE PETITIONERS

MR. OSTRAGER: Mr. Chief Justice and may it please the Court:

* * *

[4] * * *

QUESTION: Subject to due process, though, is that not right? No full faith and credit if there's been no due process in the rendition of the judgment.

MR. OSTRAGER: Yes, Your Honor, and in addition the Marrese test indicates that full faith and credit must be granted unless there is an express or implied repeal by the after-enacted statute.

* * *

[7] * * *

QUESTION: So you say that any court, looking at the record that was made on the adequacy of representation here, would conclude on that record that the representation was adequate.

You agree with me, do you not, that it is the representatives' burden to show the adequacy and not the objectors' burden to show the inadequacy?

MR. OSTRAGER: We believe that it is for the [8] court before whom the case is pending, consistent with Rule 23 procedure, to make a determination concerning the adequacy of representation.

QUESTION: Who has the burden under Rule 23?

MR. OSTRAGER: I believe it would be the class representatives, and I believe it important to know that in this case, in which the adequacy of representation was actually litigated, the respondents in this case were not the type of sideline-sitters who were referred to by Justice Stevens in his dissent in Martin v. Wilkes.

* * *

[22] * * *

QUESTION: Mr. Monaghan, the question presented in the petition for certiorari is whether a Federal court [23] can withhold full faith and credit from a State court final judgment approving a class action settlement simply because the settlement included a release of exclusively Federal claims.

Respondents phrase the question, did the court below err in refusing to give preclusive effect to a Delaware settlement and release to the extent that the Federal claims were factually and legally unrelated to any State law claims.

No question of due process or adequacy is raised in the petition. You didn't cross-petition. This would be a totally alternate ground for affirmance.

MR. MONAGHAN: Your Honor, two points. I think first of all, we are respondents, and we can defend the judgment on any ground consistent with the record. This point was the central point of our argument below.

Secondly, even if we were in the petitioner's point of view, are in that position, this question is fairly included within the petition. The real question in the case — and they've reframed their question, incidentally, from their brief to their reply brief. The real question is, did the Ninth Circuit disregard erroneously what happened in Delaware?

QUESTION: Well, that certainly isn't the question — it's a much narrower question presented by the [24] petition, whether the State court can release Federal claims as well as State claims.

MR. MONAGHAN: It can't release those claims, Your Honor, if in doing so it would violate the Due Process Clause. They conceded that.

QUESTION: Well, that wasn't — the Ninth Circuit — the Ninth Circuit said they couldn't do it simply because State courts didn't have that authority.

MR. MONAGHAN: The Ninth —

QUESTION: And so I think, fairly understood, that was the question presented on certiorari.

MR. MONAGHAN: Well, I think — well, all I can say is, Your Honor, that whether or not that's the question that

they presented on certiorari, there was countless case law in this Court that we can defend a judgment —

QUESTION: Well —

MR. MONAGHAN: — on any ground consistent with the record.

QUESTION: — Mr. Monaghan, I think you're at some risk here today if you are unwilling to even argue the question on which cert was granted.

MR. MONAGHAN: Oh, I'm —

QUESTION: It's a question that I intend to deal with when I get to work on the case, and I would assume [25] you'd want to deal with it here —

MR. MONAGHAN: I —

QUESTION: — and not go off on some peripheral issues that aren't here.

* * * *